

BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF WASHINGTON

In the Matter of the)
Application regarding the)
Conversion and Acquisition)
of Control of Premera Blue) Docket No. G02-45
Cross and its Affiliates)
)
)
)

Adjudicative Hearing
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Day 11
(Pages 2388 to 2582)
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Taken Before:

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P R O C E E D I N G S

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JUDGE FINKLE: Ready to proceed?

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MR. KELLY: Yes. We have just one preliminary matter with Ms. Hamburger in regard to the witnesses for the Intervenorors who are not appearing live in person or by phone.

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MS. HAMBURGER: Yes, Your Honor. We have agreed with the parties to - if this is agreeable to you all, is to identify on the exhibits of the prefiled testimony the people who didn't testify, that is unsworn testimony, and to then have them admitted into the record formally that way. And the numbers of the Intervenorors - of the Washington Intervenorors' exhibits that should be treated that way are Intervenorors' Exhibits 65, 67, 76 and 78. And then the Alaska Intervenorors also have some exhibits along those same lines.

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MS. McCULLOUGH: And ours are I-151, I-152, I-153, I-154 and I-164.

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MR. KELLY: That's acceptable to us, yes.

MR. HAMJE: We have one other item that is a housekeeping --

24

25

JUDGE FINKLE: Let me just close that one off. That is agreed with by you?

1 MR. HAMJE: Yes, it is, we agree to that.

2 JUDGE FINKLE: So that is admitted.

3 MR. HAMJE: The only other item there was in the
4 Intervenor's Exhibit I-162, which is as - it has been
5 admitted. My understanding is it has been admitted. It is
6 a redacted version of the Signal Hill report, which is the
7 investment banking consultant for the Alaska Division of
8 Insurance. There are a number of charts, pages that have
9 been redacted in that exhibit.

10 What we would propose to do is substitute an unredacted
11 version for the Commissioner into the record so that that
12 would be appropriate. I have already passed out copies of
13 the unredacted versions to all the parties. And I wanted to
14 go ahead and ask at this time if it would be appropriate to
15 come forward and substitute the - the unredacted version
16 from the redacted version.

17 JUDGE FINKLE: What are the parties' positions?

18 MR. MITCHELL: We have no objection to that so long
19 as the document is treated as attorneys' eyes only.

20 JUDGE FINKLE: Intervenor's?

21 MS. McCULLOUGH: Yeah. In that case, perhaps, it is
22 appropriate to have both the unredacted and the redacted in
23 so that the unredacted - so the redacted can be made
24 available to the public and the unredacted can be treated
25 for attorneys' eyes only.

1 MR. HAMJE: And maybe what we should do is
2 differentiate it, like give it a 162A or something like
3 that, designated in that regard. Would that be useful?

4 JUDGE FINKLE: That's pretty conventional and I
5 suggest you do that, if that's acceptable to everyone.

6 MR. MITCHELL: Unless there be any misunderstanding,
7 it is my understanding several other exhibits contain
8 attorneys' eyes only information so they are not
9 presumptively all going to be made public. And I assume we
10 would have an opportunity to redact them, if that's
11 ultimately desired to be done.

12 JUDGE FINKLE: Right. Nothing in this matter will
13 change any of the previous rulings or agreements or
14 designations related to AEO or confidential materials.

15 So let's call the unredacted Signal Hill report I-162
16 and the redacted 162A.

17 MR. HAMJE: So the --

18 MS. McCULLOUGH: Judge Finkle, since the redacted
19 has already been marked as 162, can we switch that around?

20 JUDGE FINKLE: Sure. Let's do that. So 162A is the
21 unredacted.

22 MR. HAMJE: So I'm going to mark this one right now
23 as "A" and I'm going to hand it up to your clerk.

24 JUDGE FINKLE: Sounds good.

25 MR. HAMJE: Thank you.

1 JUDGE FINKLE: And both of those are admitted.

2 MS. HAMBURGER: Your Honor, one other housekeeping
3 matter. We have the Intervenor's designations for the
4 deposition of Aaron Kaatz, which I provided to the parties
5 but would like to provide to - to you and the Commissioner.

6 JUDGE FINKLE: Okay.

7 Okay. Any other preliminary matters?

8 MR. HAMJE: I will just add this, is that we are
9 still working on getting those designation packets together
10 and we hope to have that completed for submission at the
11 close of evidence.

12 JUDGE FINKLE: And I'm assuming that consistent with
13 the agreement yesterday afternoon, you have shared the
14 potential rebuttal witnesses.

15 What is your sense of timing for the rest of the day?
16 How long roughly would you expect to be on cross of
17 Mr. Odiorne?

18 MR. MITCHELL: My estimate is 45 minutes to an hour.

19 MR. COOPERSMITH: The Intervenor's don't anticipate
20 much cross on Mr. Odiorne.

21 JUDGE FINKLE: And what's the status of rebuttal
22 evidence?

23 MR. COOPERSMITH: And the Intervenor's have not
24 offered any witnesses in rebuttal, Your Honor.

25 MR. MITCHELL: Premera anticipates calling two

1 witnesses in rebuttal, total testimony time would be about
2 45 minutes.

3 MR. COOPERSMITH: And which of the two would that
4 be, Rob?

5 MR. MITCHELL: That would be Mr. Steel and
6 Mr. Barlow.

7 MR. HAMJE: It is possible that there will be some
8 need for us to call a rebuttal witness. We designated
9 Mr. Cantilo and Mr. Odiorne as our potential rebuttal
10 witnesses. At this time, I don't know if we are going to
11 call them or how long they will be on the stand if we did
12 call them.

13 JUDGE FINKLE: Well, let's tentatively assume that
14 we will break at the conclusion of evidence, whenever it is,
15 if it is a bit before noon, a bit after noon, and then take
16 a lunch and then have closings, probably with a break during
17 closing, but conclude today, even if it means running a bit
18 late.

19 And it sounds from what you are saying that it shouldn't
20 require us running late, but if we need to, let's plan to do
21 that, at least tentatively.

22 Anything else before we proceed with cross?

23 MR. MITCHELL: Well, one little question, Your
24 Honor. I was marking down in my exhibit notebook the
25 exhibits that have been admitted as unsworn testimony and I

1 don't have an I-164 on my index, so I'm curious to know what
2 that is.

3 MS. McCULLOUGH: I-164 is the revised testimony of
4 the Karen Perdue testimony. We anticipated that last Friday
5 in anticipation that she might be testifying. In that
6 regard, we will submit the revised testimony in accordance
7 with your ruling either today or by the end of the week.

8 MR. MITCHELL: So is the plan to substitute those
9 for exhibits I- --

10 MS. McCULLOUGH: Yes.

11 MR. MITCHELL: Okay.

12 JUDGE FINKLE: You probably should have a clear
13 conclusion of submissions to the record. The suggestion was
14 that it be by the end of the week in this particular case.

15 What are your thoughts about whether that's an
16 appropriate time to conclude all kind of last minute
17 updating of exhibits and such?

18 I wouldn't expect that there would be much, if any,
19 additional required, but we don't want to just sort of drift
20 along and potentially have additional submissions to the
21 record.

22 MR. MITCHELL: I'm not aware of any issues, Your
23 Honor, from Premera's standpoint, but I think at the end of
24 this week would be an appropriate time to have all materials
25 into the record that deal with exhibit issues that we have

1 identified thus far.

2 And if there are any additional issues relating to
3 exhibits, they should be brought to the parties' attention
4 and I think to the Commissioner's by the close of evidence.

5 MR. COOPERSMITH: The Intervenors will do whatever
6 is the Court's pleasure.

7 MR. HAMJE: Your Honor, if I understand what you are
8 saying correctly - and I want to make sure - is you are
9 suggesting that the record remain open for basically
10 housekeeping purposes in terms of making sure that the - all
11 of the exhibits and other items that have been discussed are
12 submitted by Friday; is that my understanding?

13 JUDGE FINKLE: Right. Normally --

14 MR. HAMJE: Is that correct?

15 JUDGE FINKLE: -- if there were a trial, at the
16 conclusion of evidence I would give you an opportunity to
17 make absolutely sure that the record was squared away.
18 There are lot of exhibits that have been admitted. It is
19 possible, as you review them, you will find that there is
20 some minor flaw in the form of the exhibit that was
21 submitted.

22 The absolute deadline for clarifying is this Friday. If
23 there is any issue, you can submit it to me as a
24 nondispositive motion and I will rule on it. I'm not
25 expecting that, but bear in mind, this is purely a technical

1 correction, not an opportunity for submitting additional
2 materials.

3 MR. HAMJE: I could see where we would find it
4 useful in the sense of trying to make sure our
5 cross-designations with respect to the depositions - it
6 would give us some time to make sure it is all correct and
7 complete.

8 JUDGE FINKLE: That's the primary purpose of leaving
9 this open for a few days.

10 Are we set to go?

11 MR. HAMJE: Yes.

12 JUDGE FINKLE: Mr. Odiorne?

13
14 CROSS-EXAMINATION

15
16 BY MR. MITCHELL:

17 Q Good morning, Mr. Odiorne.

18 A Good morning, Mr. Mitchell.

19 Q I want to ask you, first, a couple of questions about
20 allocation. You testified yesterday afternoon that you were
21 personally involved in negotiations with your Alaska
22 counterparts about allocation issues; is that correct?

23 A That's correct.

24 Q In those negotiations, Mr. Odiorne, what was your most
25 generous offer?

1 A I'm a little concerned there because there was an agreement
2 between us and Alaska about resolving that 408 letter issue
3 and I'm not sure that I can testify about those.

4 Q Let's pass by that.

5 Would I be safe in assuming that it was somewhat higher
6 than the number that you suggested yesterday?

7 A That - I'm sorry?

8 Q Your most generous offer to Alaska would give them a
9 somewhat larger percentage than the number you suggested
10 yesterday in your recommendation?

11 A Yes.

12 Q Did you ever suggest to your Alaska counterparts,
13 Mr. Odiorne, that it would be appropriate to accept
14 Premera's proposal for a 90/10 or an 88/12 split?

15 A I think that early on was a good decision, yes.

16 Q I gather, though, that the negotiations that you have had
17 with the Alaskans proceeded upon the presumption that
18 Premera had a charitable obligation running to both states;
19 is that right?

20 A The assumption was that the value of Premera will be
21 transferred to the foundations. I wasn't operating on
22 assumptions that it was charitable, just the articles of
23 Premera require assets to be transferred.

24 Q You - I want to ask you a couple of questions about
25 instructions, Mr. Odiorne.

1 First, you formulated the issues to be addressed by
2 Mr. Cantilo in his reports, did you not?

3 A Yes. We gave each consultant instructions about the areas
4 we wanted them to look at.

5 Q Among the issues you asked Mr. Cantilo to address was the
6 economic viability of the transaction; is that right?

7 A I believe that may have been one of the outlines that we
8 gave him, yeah.

9 Q And you told Cantilo & Bennett to consider the value
10 received by the foundation shareholder and evaluate the
11 economic viability of the appropriate transaction, did you
12 not?

13 A I'm sorry. That was a long time ago. I don't remember the
14 specifics of the instructions. I think they were included
15 in the contract with Cantilo.

16 Q Economic viability is not a test under the Holding Company
17 Acts, is it?

18 A No.

19 Q With respect to Blackstone, you initially told Blackstone to
20 perform an evaluation of Premera; is that correct? Is that
21 right?

22 A I think early on that was the request.

23 Q And later you told Blackstone not to perform an evaluation,
24 as I understand it; is that right?

25 A That's correct.

1 Q And am I correct in my understanding that the reason for the
2 change in direction is that you were informed by Blackstone
3 that the value of the stock to be transferred can be
4 established only after Premera - I'm sorry. Only after this
5 - there is a public market for the stock, that is only after
6 the IPO?

7 A I don't believe so.

8 Q Did Blackstone inform you that there was no reliable way to
9 perform evaluation in advance of the IPO, certainly not long
10 before the IPO?

11 A I don't remember that.

12 Q You advised Blackstone that an IPO conducted in a reasonable
13 and customary manner could deliver fair value to the
14 foundations, did you not?

15 A I believe that's correct.

16 Q And you understood that Blackstone was going to do an IPO
17 procedures opinion aimed at precisely that issue, mainly
18 whether or not the IPO was going to be conducted in a
19 reasonable and customary manner; is that not true?

20 A Can you identify for me the time frame you are talking
21 about?

22 Q At the time that you were giving Blackstone his assignments,
23 you understood that Blackstone was going to prepare an IPO
24 procedure, did you not?

25 A I don't remember the IPO procedures opinion being included

1 upfront.

2 Q And it is, however, part of the Blackstone assignment at
3 this juncture, is it not?

4 A I believe that it is.

5 Q And then you instructed the Blackstone folks to give you a
6 fairness opinion; is that right?

7 A Yes.

8 Q What is a fairness opinion, as you understand it,
9 Mr. Odiorne?

10 A As I understand it, it would be a review of the entire
11 transaction and the IPO in fairness to all the parties
12 involved.

13 Q And what does "fair value" mean in this context?

14 A As I understand it, fair value means - "full value" is the
15 term I used yesterday. It's the value of Premera prior to
16 the transfer.

17 Q So you used the term to be - to reflect an evaluation of
18 Premera's value before the transfer rather than after the
19 transfer?

20 A Well, at the point of transfer, I believe, is where it
21 happens.

22 Q Did you instruct the consultants, Mr. Odiorne, to assume
23 that public owns Premera?

24 A I don't remember giving that instruction.

25 Q Did you instruct the consultants to assume that Premera's

1 assets are subject to charitable use restrictions?

2 A I don't remember that instruction.

3 Q Did you instruct the consultants to assume that Premera is
4 legally obligated to transfer the fair market value of its
5 assets upon dissolution?

6 A I think that there was an instruction that there was a
7 requirement to transfer assets, yes.

8 Q When did you give that instruction, Mr. Odiorne?

9 A I honestly don't remember the exact time.

10 Q Was it early in the process of the consultants' work?

11 A I think it was.

12 Q You instructed Blackstone not to conduct an analysis of
13 alternative uses that Premera could make of new capital that
14 it was proposing to raise through the IPO, did you not?

15 A I don't remember that at all.

16 Q Do you recall any conversation with Blackstone or with
17 Cantilo & Bennett on the subject of whether Blackstone
18 should do such an analysis which would show additional value
19 going to the foundation?

20 A I'm sorry. I lost part of your question.

21 Q Do you recall any conversation with Blackstone or Cantilo &
22 Bennett the subject of which was an evaluation by Blackstone
23 of alternative uses that could be made of the capital that
24 could be raised through an IPO?

25 A I do not remember that discussion.

1 Q In referring to the sources of information that led to your
2 recommendation, Mr. Odiorne, you mentioned Premera's
3 articles of incorporation, among other things.

4 When did you first consider the language in Article 12
5 of Premera's current articles of incorporation?

6 A I don't remember the first time I specifically looked at
7 them. I'm assuming that it was early on.

8 Q Was - did Mr. Cantilo bring that language to your attention
9 after his deposition in March of this year?

10 A No.

11 Q Did you bring that language to Mr. Cantilo's attention after
12 his deposition in March of this year?

13 A No.

14 Q Is it not the case, Mr. Odiorne, that Premera never stated
15 to you or in your presence that it believed it had an
16 obligation to transfer the fair market value of its assets?

17 A If you mean stated verbally, I would have to agree with you.

18 Q That they never did?

19 A They - I do not remember a verbal statement of that sort.

20 Q Let's turn then, if we might, to the factors that you
21 testified underlie your recommendation to the Commissioner.

22 The first such factor is Premera's financial stability,
23 I believe you testified. Am I correct in my understanding,
24 Mr. Odiorne, that in referring to financial stability you
25 are referencing the test in the Holding Company Acts that

1 asks whether the financial condition of New Premera is such
2 that it might jeopardize the financial stability of Premera?

3 A That is the test.

4 Q And that factor, actually, favors the proposal in Premera's
5 Amended Form A, does it not?

6 A I don't believe so.

7 Q You mentioned in your testimony that Premera is financially
8 constrained in capital, I believe, Mr. Odiorne. Would you
9 not agree with me that bringing a 100 to 150 million dollars
10 in new capital would substantially boost Premera's RBC,
11 relieve its capital limitations and strengthen the company?

12 A It might.

13 Q Under what circumstances would bringing 100 to 150 million
14 dollars of new capital into the company not strengthen --

15 A It would depend on how it is used, where it is put, what the
16 constraints are on it.

17 Q Assume for the moment, Mr. Odiorne, that the capital is put
18 aside just to strengthen Premera's RBC reserves. Would you
19 not agree that the introduction of such capital would, in
20 fact, substantially boost Premera's RBC, relieve its capital
21 limitations and strengthen the company?

22 A At the moment of infusion, yes.

23 Q Did you ever suggest to Premera a concern about the
24 financial stability of Premera postconversion?

25 A I don't believe that I personally discussed that with

1 Premera.

2 Q Are you at all concerned in referring to this particular
3 factor that every one of your consultants that have
4 considered the issue has concluded that Premera will be
5 financially stronger after the conversion than it is today?

6 A I don't remember that from the consultants.

7 Q So do I understand your testimony to be, Mr. Odiorne, that
8 the financial condition criterion argues against the
9 conversion?

10 A Yes.

11 Q And let's talk about the other two items you covered under
12 the same heading. One is the risk of losing the Section
13 833(b) deduction. I take it with respect to that particular
14 issue you have nothing to go on beyond what Mr. Ashley has
15 reported to you in his tax report and in his testimony; is
16 that right?

17 A I - that's my recollection currently.

18 Q Isn't an increase in federal taxes an inevitable consequence
19 in virtually every nonprofit conversion?

20 A I'm not sure. I haven't studied that.

21 Q Well, let's take the nonprofit hospital conversions in
22 Central Washington as an example, Mr. Odiorne. Hospitals
23 are tax exempt, most of them. And after the conversion they
24 will be taxed at the normal federal rate; is that your
25 understanding?

1 A I really have not studied that. I don't know.

2 Q Is it your understanding that the increase in taxes
3 associated with going to for-profit status is not an
4 automatic disqualification of any conversion proposal?

5 A I'm sorry. I --

6 Q Is it your position that an increase in federal taxes
7 attendant to conversion automatically disqualifies every
8 conversion proposal?

9 A I don't believe so.

10 Q In this case is it not the case, Mr. Odiorne, that Premera
11 is already taxed for federal tax purposes and so the issue
12 that we are talking about here is the potential risk that
13 the marginal tax rate could increase?

14 A Yes.

15 Q Would you agree with me, Mr. Odiorne, that whether this
16 might happen will not be known for several years?

17 A I don't know how soon it will be known.

18 Q Do you have any reason to disagree with Mr. Ashley's
19 observation that it would have no impact whatsoever until
20 2007 at the earliest?

21 A I don't remember that he made that observation, but I would
22 give some credence to his . . .

23 Q And would you agree with me, Mr. Odiorne, that if worst came
24 to worst and the IRS determined that - or probably more
25 accurately, the court determined that Premera could not

1 maintain its 833(b) deduction, that the loss of that
2 deduction would have no impact on its RBC?

3 A I'm not sure I understood fully your question.

4 Q Well, let me ask the question this way: Is it your
5 understanding that the marginal tax rate is an issue for the
6 balance sheet or for the financial statements, income
7 statement?

8 A It eventually affects both.

9 Q It has no immediate impact on the balance sheet, though,
10 does it?

11 A No immediate impact, no.

12 Q All it does is potentially reduce the opportunities to add
13 over time to the capital in the balance sheet; isn't that
14 right?

15 A That's one interpretation, yes.

16 Q And let's assume for purposes of my question, Mr. Odiorne,
17 that the RBC has already been raised by 100 to 150 million
18 dollars. Do you believe that the potential loss of the
19 special tax deduction, which may be felt some years down the
20 road and may have some longer term impact on the RBC, is a
21 disqualifying factor for this proposal?

22 A I didn't quite follow your question because RBC isn't
23 figured in the 100 million dollars. It's figured in
24 percentages.

25 Q Well, okay. Let's assume, then - I apologize. Let's assume

1 the 100 to 150 million dollars goes to bolster Premera's
2 reserves and as a result of the infusion of that capital
3 Premera's RBC is between 500 and 600.

4 A Okay.

5 Q Let's assume that that is a consequence of the proposal that
6 you are evaluating, Mr. Odiorne. Is it your testimony that
7 the possible loss of the 833(b) deduction is sufficient to
8 offset that and render questionable financial stability of
9 New Premera?

10 A I think it is possible, yes.

11 Q And how might the loss of an 833(b) deductions, Mr. Odiorne,
12 offset an increase in Premera's RBC of 100 to 150 points?

13 A I'm not sure of the calculation. I understood that the loss
14 of the 833(b) over time would result in several hundred
15 million dollars of additional taxes.

16 Q Really? What is the source of that understanding?

17 A I think that came from Mr. Ashley.

18 Q Several hundred dollars - hundred million dollars in
19 additional taxes?

20 A That's what I remembered, yes.

21 Q And are you assuming that the federal taxes are paid at a
22 marginal rate on Premera's gross revenues or on its net
23 income?

24 A I believe it was calculated on net income. I don't have
25 that with me just now.

1 Q If Premera's net income is 1.7 percent of its gross
2 receipts, Mr. Odiorne, and the marginal tax rate on net
3 income raises from 20 to 35 percent, how do you get to
4 hundreds of millions of dollars?

5 A I don't remember the calculations just now.

6 Q Would you not agree with me, Mr. Odiorne, that in additional
7 to the potential infusion of capital associated with the IPO
8 that is under discussion here, that Premera's proposal would
9 afford it opportunities to access capital markets in the
10 future for additional capital as needed?

11 A That's a potential.

12 Q And that's an advantage of the proposal over things as they
13 now stand, is it not?

14 A It can be.

15 Q Doesn't it support the proposition that the financial
16 condition of New Premera would be superior to that of
17 present day Premera?

18 A I'm not sure that it does.

19 Q You mentioned, I think, the last factor here, that Premera's
20 economic assurance is a concern.

21 A Yes.

22 Q I take it, Mr. Odiorne, that you would not favor extending
23 those assurance beyond the two-year term that is currently
24 set forth in the Amended Form A; is that right?

25 A I would say that it is not an advantage to Premera.

1 Q Now, the economic assurances that we are talking about here
2 were not in the original Form A filing, were they?

3 A That's my understanding.

4 Q Indeed, they were negotiated by your economic consultants
5 following the original reports issued in this matter; isn't
6 that right?

7 A Yes.

8 MR. MITCHELL: May I approach, Your Honor?

9 JUDGE FINKLE: Yes.

10 Q (BY MR. MITCHELL) Mr. Odiorne, I have handed you what has
11 been marked as Exhibit P-222. Do you recognize that
12 document?

13 A I believe I have seen it before, yes.

14 Q And you are one of the cc recipients on this e-mail from
15 Ms. Hunt and Mr. Domeika, are you not?

16 A Yes.

17 Q And does that e-mail confirm that the economic assurances
18 that are set forth in the Amended Form A were negotiated to
19 the satisfaction of the economic consultants to the OIC
20 staff, other than with respect to the term of the agreement?

21 A Yes.

22 MR. MITCHELL: Move the admission of Exhibit P-222.

23 MR. HAMJE: No objection.

24 MR. COOPERSMITH: No objection.

25 JUDGE FINKLE: Admitted.

1 Q (BY MR. MITCHELL) Mr. Odiorne, during the course of the
2 negotiations between Premera and the PwC folks on these
3 economic impact assurances, did you ever advise either PwC
4 or Premera that you were concerned about the impact of the
5 assurances upon Premera's economic stability?

6 A I don't believe I focused on that issue.

7 Q What is the impact of these assurance upon Premera's
8 financial stability, Mr. Odiorne?

9 A It - it is my impression that those assurances limit
10 Premera's ability to respond to market conditions.

11 Q Is it your impression, Mr. Odiorne, that the impact of those
12 assurances upon Premera is in any way comparable to the
13 impact of receiving an infusion of 100 to 150 million
14 dollars cash upon an IPO?

15 A I don't have a calculation to show that.

16 Q Am I correct in my understanding, Mr. Odiorne, that you
17 weighed these three factors that we have just discussed, the
18 loss of the 833(b) deduction potentially, the economic
19 assurances with their two-year life, and determined that
20 they outweighed any advantage in terms of the infusion of
21 new capital to Premera's financial stability?

22 A I think my weighing indicated that it was - these factors
23 were adverse to Premera's financial position.

24 Q And you considered nothing that might be favorable to it in
25 doing your analysis, did you?

1 A It was part of what I heard and I can't say that I
2 specifically laid them all out side by side.

3 Q Now, you heard the testimony of Sally Jewell --

4 A Yes.

5 Q -- and three other board members, as well as several senior
6 executives from Premera in terms of the reasons for pursuing
7 conversion and seeking new capital, did you not,
8 Mr. Odiorne?

9 A I heard that testimony.

10 Q And did you conclude, after hearing all of that testimony,
11 that Premera was engaged in a foolish errand, that it was
12 basically pursuing something that would harm its financial
13 stability?

14 A I don't think that decision was made upfront when
15 Ms. Jewell was testifying.

16 Q You decided it after you heard everybody testify; is that
17 right?

18 A Yes.

19 Q Well, let's turn, then, to the next factor you considered,
20 which was whether the terms of the transaction are fair and
21 reasonable. That's a Form D test, not a Form A test, is it
22 not?

23 A It is included in that section, yes.

24 Q The Form D section?

25 A Yes.

1 Q And you agree with Mr. Cantilo, do you not, Mr. Odiorne,
2 that the only aspect of this transaction that raises
3 concerns from a Form D standpoint is the guarantee,
4 specifically that the claims coverage language for the
5 Alaska subsidiary should be echoed in the guarantee for a
6 New Premera Blue Cross, which would cover Washington
7 residents?

8 A No.

9 Q You don't agree with that?

10 A I don't.

11 Q What other Form D transactions are problematic from your
12 standpoint?

13 A I think that the entire transaction is subject to the fair
14 and reasonable conditions set out in that particular section
15 of the code.

16 Q So you disagree with Mr. Cantilo in that subject; is that
17 right?

18 A Yes.

19 Q With respect to the guarantee, would you agree with me,
20 Mr. Odiorne, that there is an easy fix for that particular
21 concern, mainly to require that the language of the
22 Washington guarantee mirror that of the Alaska guarantee?

23 A If they were identical, then I wouldn't have the issue that
24 I have.

25 Q And you heard Mr. Marquardt's testimony that that would be

1 entirely acceptable to Premera, did you not?

2 A I heard that testimony.

3 Q Under the heading of "Fair and Reasonable Terms,"
4 Mr. Odiorne, you referred to the need for a complete
5 description of the transaction. Do you remember that?

6 A Yes.

7 Q Is it your testimony that Premera's Form A is incomplete or
8 deficient?

9 A Yes.

10 Q I thought, Mr. Odiorne, that the Staff identified all
11 alleged deficiencies last fall in response to Judge Casey's
12 order. Did I miss something there?

13 A I don't remember what they responded to, Judge Casey's
14 order.

15 Q What alleged deficiencies in the Form A exist today, by your
16 reckoning?

17 A From my perspective, there is not a description of how the
18 total package of the transaction fits together, including
19 the uses that will be made of any potential capital raise.

20 Q So the problem, from your perspective, is that Premera has
21 not spelled out in detail how it would spend the money it
22 would raise at the IPO?

23 A Yes, that's the problem.

24 Q Would you also expect, Mr. Odiorne, that Premera would spell
25 out how it would propose to use the proceeds of any further

1 capital infusions that it might seek from the equity market?

2 A Yes.

3 Q So if Premera 10 years from now decided to go back to the
4 equity markets to meet some new challenge in that decade, is
5 it your testimony that the Commissioner could not evaluate
6 this proposal without knowing precisely how Premera would
7 spend that money?

8 A I think a future dip into the equity market would require a
9 solicitation permit that does require spelling out what the
10 procedure is for.

11 Q Well, that's an excellent point, Mr. Odiorne, because you, I
12 think, agreed that solicitation permits are appropriately
13 required in this transaction, only sometime down the road,
14 did you not?

15 A Before the transaction can be completed, yes.

16 Q Right. And I don't think Premera has ever disagreed with
17 you that solicitation permit wills be required at that point
18 in time, has it?

19 A I haven't heard a disagreement on that.

20 Q Do you recall the testimony by your investment banking
21 consultants, Mr. Odiorne, that it is premature at this point
22 even to decide the amount of the IPO or the share of the IPO
23 between Premera and the foundations?

24 A I think I remember that.

25 Q And if that's the case, Mr. Odiorne, would you not also

1 agree that it is premature at this point to decide how one
2 might spend money when one doesn't know whether it is going
3 to be 10 million dollars or 150 million dollars?

4 A No.

5 Q No, you don't agree with that?

6 A I don't agree with that.

7 Q So your - your statement is that the Commissioner cannot
8 evaluate this proposal without knowing exactly how Premera
9 is going to spend every dime of the money it raises in the
10 IPO?

11 A I don't know that we are talking about dimes, but I think
12 big chunks of money he ought to know about.

13 Q Let's assume for the purposes of this question, Mr. Odiorne,
14 that Premera has no specific plans for the money, other than
15 to put the money into its reserves and boost its RBC to 550
16 to 600 percent. I believe that's the assumption that
17 Premera asked you and the consultants to make in terms of
18 evaluating the economic impact of the transaction.

19 Is it your testimony that the Commissioner cannot
20 evaluate a transaction with those terms?

21 A Some evaluation, I'm sure, is possible.

22 Q And in this case you have looked at 40,000 pages of
23 documents, you have conducted 18 months' worth of research,
24 your consultants have spent somewhere up of 11 million
25 dollars and you believe you don't have enough information to

1 evaluate the transaction; is that right?

2 A The transaction as defined by the Form A, that's correct.

3 Q I think in the same context, Mr. Odiorne, that you refer to
4 the phrase "management entrenchment." My recollection is
5 that there is only one witness in this proceeding who has
6 used that phrase, that being Mr. Cantilo. Is there anybody
7 else that you recall hearing that spoke about that issue?

8 A I don't remember that specific term from anyone else.

9 Q When you used the term "management entrenchment,"
10 Mr. Odiorne, are you talking about board entrenchment or
11 something else?

12 A I think the two go hand in hand. If the board stays,
13 management is likely to stay.

14 Q What in the testimony of Ms. Jewell, Dr. Gollhofer, Mr. Fox,
15 Mr. Fahey or any other witness suggests to you that the
16 board is motivated in pursuing this transaction by a desire
17 to entrench itself?

18 A As I remember the testimony from some of the witnesses, was
19 that the Association's rules required the board to remain.

20 Q Of course, if the company doesn't convert, the board
21 remains, too, doesn't it?

22 A That's correct.

23 Q It is a self-perpetuating board, is it not?

24 A That's correct.

25 Q So how is it that entrenchment comes into play here at all?

1 In fact, isn't the board exposing itself to the potential
2 for being dislocated more under this proposal than under the
3 current circumstances?

4 A I'm not sure I understand how they would do that.

5 Q Is it your testimony, Mr. Odiorne, that instead of remaining
6 a local, vibrant company committed to delivering on its
7 mission, Premera should have shopped itself to Anthem or
8 some other outside entity?

9 A I'm not following your question exactly.

10 Q Is it your testimony that there is any obligation on a
11 company proposing an acquisition subject to the Holding
12 Company Act that it actually pursue, among other things, a
13 sale of the company to a third party rather than the
14 proposal that it advances?

15 A I think the company is required to fully explore all
16 possibilities.

17 Q What is the course of that obligation, Mr. Odiorne, in the
18 Holding Company Act?

19 A I think the fair and reasonable standard comes in there.

20 Q In what prior Form A, Mr. Odiorne, have you asked the
21 company to justify its application by explaining to you all
22 other alternatives that it explored?

23 A I think that's part of every application.

24 Q Do you have any reason to believe, Mr. Odiorne, that the
25 board acted unreasonably in reaching the conclusion that

1 conversion was the best alternative for Premera's future,
2 for its subscribers and for the insurance-buying public?

3 A I'm sorry. Try that --

4 Q Do you have any basis to - to conclude, Mr. Odiorne, that
5 the board of Premera acted unreasonably when it concluded at
6 the ends of its due diligence process that a conversion was
7 the best alternative for Premera?

8 A I think for me the fact that the board kind of automatically
9 said we are going to remain local and not go out prevented
10 them from looking at all of the options fully.

11 Q Is there anything in any of the consultant reports that you
12 had before you or in the testimony that you heard,
13 Mr. Odiorne, other than Mr. Cantilo's, that supports that
14 observation?

15 A My recollection is that Ms. Jewell and the other board
16 members - is that they quickly passed over the option of
17 selling or merging. It was pretty decided that they wanted
18 to stay where they were.

19 Q That's your recollection of their testimony?

20 A That's my recollection.

21 Q Do you have any reason to believe, Mr. Odiorne, that any
22 alternative approach that might have been taken by the board
23 would have given it greater value?

24 A I don't know what all the other alternatives were, so I
25 don't know.

1 Q So it is your testimony, as I understand it, that the board
2 should go back on the work that it did for the 12-month
3 process leading up to May of 2002 and the preceding work in
4 2001 and the work with Goldman Sachs in 1997 and 1998, and
5 start over again; is that your testimony?

6 A I'm not saying they should start over again.

7 Q One of the things that I noticed in your statement of
8 reasons, Mr. Odiorne, is that you do not mention licensure
9 concerns. Am I correct in my inference that the possibility
10 of New Premera's being registered as a health carrier - a
11 healthcare service contractor is not an issue for you in
12 this proceeding?

13 A That's correct.

14 Q It's not a basis to deny the Form A application, is it?

15 A We agreed upfront that we would allow the transfer of the
16 license.

17 Q And one of the other things you did not mention in your
18 recitation of reasons is a concern about competitive injury,
19 or the antitrust inquiry under the Form A test. Am I
20 correct in inferring that that is not an issue for you in
21 this proceeding?

22 A I think it is an issue. It is just not one that I
23 highlighted for the Commissioner.

24 Q Do you have any reason to disagree with Dr. Leffler's
25 testimony that there is no reason to believe that - that

1 there is no substantial evidence of any substantial harm to
2 competition arising from this proposed transaction?

3 A I don't remember his testimony in that way.

4 Q Why don't you assume for the purposes of my question,
5 Mr. Odiorne, that Dr. Leffler testified precisely that, that
6 there was no substantial evidence of any substantially
7 competitive injury attendant to this transaction.

8 Based on that assumption, do you have any reason to
9 disagree with the conclusion that there is no evidence to
10 support a claim of competitive harm arising from this
11 proposed conversion?

12 MR. COOPERSMITH: Objection. Calls for the witness
13 to speculate.

14 JUDGE FINKLE: Overruled.

15 A My recollection is that Dr. Leffler testified at a point in
16 time when he did his study - and there was other testimony -
17 that there had been changes in the market since that time.
18 I think there is a chance that there could be some
19 competitive harm.

20 Q (BY MR. MITCHELL) To whom?

21 A To the public that Premera serves.

22 Q You understand the concept of competitive harm, Mr. Odiorne,
23 to relate to the competitors of Premera in the marketplace,
24 that is to Regence, Group health, Aetna, United and the
25 like?

1 A I think the harm is to the subscribers.

2 Q I see. So am I correct in my understanding that your
3 interpretation of this particular test is that it is the
4 same as the question whether there is any harm to
5 subscribers?

6 A I think they are very closely related.

7 Q Is there distinction in your mind between the test that
8 looks at whether the proposed transaction will be unfair and
9 unreasonable to subscribers and not in the public interest
10 and the test that asks whether there is any substantial
11 evidence of competitive injury?

12 A Did you say were they the same tests?

13 Q I'm asking whether you see any substantial differences
14 between them.

15 A I think they are related. There are some differences, yes,
16 but I think they are closely related.

17 Q Putting aside for the moment the issue of subscribers to
18 which we will return momentarily, is there any basis in the
19 record that you have before you in your hearing of this
20 testimony to suggest that there will be specific harm to the
21 competitive marketplace, that is to Premera's competitors,
22 arising from this transaction?

23 A I think the harm to the marketplace is the benefit to
24 Premera as much as the harm to its competitors.

25 Q I see. So anything that strengthens Premera necessarily and

1 harms its competitors; is that your testimony?

2 A No. I said it is a harm to the marketplace.

3 Q And by marketplace, you are talking about the market for
4 what? The sale of insurance policies?

5 A Yes.

6 Q The harm to the marketplace, then, is that the question that
7 was explored by the PwC economic impact team through its
8 model that is of Eastern Washington?

9 A Yes.

10 Q Is there anything else?

11 A I think that was focused on Eastern Washington.

12 Q The next thing you talked about was the Blue marks,
13 Mr. Odiorne. And do I understand your testimony to be that
14 any restriction upon Premera's license from the Blue
15 Association represents something that the Commissioner
16 should be offended by in this proceeding?

17 A I didn't say that.

18 Q You said that the Commissioner has been put in a position of
19 risking the valuable Blue mark or acceding to a
20 nongovernmental agency that was not a party to this
21 transaction, is that --

22 A I said that.

23 Q Is that your testimony?

24 There are a host of companies, are there not, with whom
25 Premera had contractual relationships that are not parties

1 to this proceeding?

2 A I don't know what a host is. I'm assuming that there are
3 some that Premera contracts with.

4 Q And you understand, do you not, that under Premera's
5 contractual relationships with many, many, third parties,
6 there are restrictions upon what Premera can do?

7 A I don't know those contracts.

8 Q Is it your position that the Blue Cross/Blue Shield
9 Association's restrictions are somehow uniquely offensive to
10 the authority of the Commissioner in deciding whether to
11 approve or disapprove this proposed transaction?

12 MR. HAMJE: Objection. Argumentative.

13 JUDGE FINKLE: Overruled.

14 A I'm sorry. I lost your question.

15 Q (BY MR. MITCHELL) Is it your testimony that the Blue
16 Cross/Blue Shield Association restrictions that arise by
17 Premera's license to use the Blue marks are somehow uniquely
18 offensive to the Commissioner's authority in this
19 proceeding?

20 A Yes.

21 Q Why?

22 A Because the entity is attempting to make decisions that
23 should be in the Commissioner's realm.

24 Q So is it your testimony that the Commissioner, not the Blue
25 Cross/Blue Shield Association, should determine what is

1 appropriate to protect the Blue marks?

2 A I don't think the Commissioner is focusing on protecting the
3 Blue marks, other than as it impacts subscribers and
4 providers.

5 Q I take it that you agree that protection of the Blues mark
6 is of substantial value to Premera's subscribers and to the
7 insurance-buying public?

8 A I think that's what the testimony is, yes.

9 Q And do you agree with that, Mr. Odiorne?

10 A I'm not sure of the value. Some value.

11 Q You said with respect to the Blue marks, Mr. Odiorne, that
12 you didn't think it was necessary for the foundations to
13 totally give up their ability to vote on significant matters
14 to Premera, just to retain the Blue marks.

15 Do you recall that?

16 A That's correct.

17 Q Is it your testimony that under the terms of the proposed
18 transaction the foundations will totally give up their
19 ability to vote?

20 A I don't think the transaction requires them to give up total
21 voting. There is significant voting that is given up.

22 Q Actually, there are fairly detailed provisions for mirror
23 voting, free voting and voting in accordance with the
24 independent directors; isn't that right?

25 A Yes.

1 Q And with respect to any issue, Mr. Odiorne, is it your
2 understanding that the foundations would be giving up their
3 vote or only that they be contractually obliged to cast
4 their vote in accordance with the provisions of the
5 transaction documents?

6 A In some instances they are contractually required to vote in
7 a particular way.

8 Q Are there instances in which they are required to give up
9 their vote?

10 A There are some.

11 Q Name them, if you would, please.

12 A I think they have given up their right to vote in those
13 areas where they are contractually controlled in their vote.
14 It is not a free vote.

15 Q So your testimony is that being required to vote in a
16 particular way is - in accordance with other people's votes
17 is akin to having no vote at all?

18 A It seems to me that way.

19 Q Your testimony is that the motion of these restrictions
20 offends you in part because the foundations will be
21 prohibited from doing anything that would avoid the disaster
22 of losing the Blues mark; is that your testimony?

23 A That's correct.

24 Q It seems a little bit ironic to me, Mr. Odiorne, that you
25 are concerned about that when the voting - the kind of

1 voting you are proposing guarantees loss of the Blues marks.

2 Am I missing something here?

3 A Well, I'm not sure what you are missing. The - I think if
4 the marks are lost, there was testimony that that would be a
5 disaster.

6 Q Mm-hmm.

7 A If the disaster is coming through that guarantee of the
8 board, management, then the majority shareholders should
9 have the right to do something about that. And under this
10 transaction, they don't.

11 Q I see. So do I understand you to be saying that it is
12 essential or is necessary to destroy the Blue marks in order
13 to save them?

14 A I didn't say that.

15 Q You testified that Premera is insisting that two separate
16 owners, the Washington foundation and the Alaska foundation,
17 share the rights that one owner should have; is that your
18 testimony?

19 A Yes.

20 Q In reality, Premera didn't insist upon that, Premera went
21 back to the Blue Cross/Blue Shield Association and made the
22 case for two separate five percent blocks, did it not?

23 A I don't know what it did.

24 Q You turned down the opportunity to go along, did you not?

25 A I didn't feel that was appropriate for me.

1 Q Are you aware that having been informed of the consultants'
2 desire that there be two separate five percent blocks, that
3 Premera called a special board meeting in less than 48
4 hours' notice?

5 A I wasn't aware that Premera called a board meeting.

6 Q Are you aware that Premera's board approved having separate
7 five percent blocks in concept subject only to the approval
8 of the Blue Cross/Blue Shield Association?

9 A I think I heard that in testimony, yes.

10 Q So you were erroneous in saying that Premera was insisting
11 upon this single block; isn't that not true?

12 A If we get down to parsing out sentences, maybe. Yes. Yeah.

13 Q Now, would you agree with me, Mr. Odiorne, that because both
14 the Alaska and the Washington foundation will at the end of
15 day own more than five percent of the company, that would
16 constitute a violation of the Blue Cross/Blue Shield license
17 agreement absent a waiver?

18 A Only if you force them into one entity.

19 Q Well, I think that we may be not understanding each other
20 clearly, Mr. Odiorne. You testified that you would
21 recommend, I think, 15 percent of the stock going to Alaska,
22 right?

23 A That's correct.

24 Q Fifteen percent is more than five percent; is that right?

25 A That's correct.

1 Q Eighty-five percent is more than five percent?

2 A That's correct.

3 Q So would you not agree with me that having two entities,
4 each of which have more than five percent ownership of
5 Premera Blue Cross, constitutes a violation of the Blue
6 Cross/Blue Shield Association's rules and requires a waiver
7 from the Association?

8 A I believe that is correct.

9 Q Now, with respect to the single five percent block of
10 shares, Mr. Odiorne, you understand, do you not, that the
11 default language there is for the five percent block held by
12 Washington, not by Alaska?

13 A I believe that's correct.

14 Q So are you here representing the interests of the Alaskans
15 in having a separate five percent block?

16 A I'm here saying it is not fair to force them into a
17 different position.

18 Q You don't know, do you, whether the Alaska director cares
19 about this issue?

20 A I have not heard from the Alaska director.

21 Q Let's assume for the purposes of my next question,
22 Mr. Odiorne, that the parties - the states agree to split
23 50/50 their five percent block of shares outside the voting
24 trust.

25 What material difference in value with having five

1 percent outside of the voting trust make relative to having
2 two-and-a-half percent?

3 A The difference that I see is that each would have a vote
4 rather than forcing one vote from --

5 Q Each would have a vote where?

6 A If - it is my understanding that the five percent is a
7 limitation somehow on some of the voting and if you force
8 each of them to have single five percent, then one of the
9 other of them is not in that voting position.

10 Q Actually, they would be voting two-and-a-half percent of
11 their shares outside of the voting trust as opposed to five
12 percent outside the voting trust, right?

13 A I would suppose.

14 Q And what difference does that make, Mr. Odiorne?

15 A Well, if you force them together, it is one vote. If you
16 leave them apart, it is two.

17 Q Actually, it is as many votes you can get by multiplying the
18 number of shares by two-and-a-half percent, isn't it?

19 A I don't have that detail with me.

20 Q Would you agree with me, Mr. Odiorne, that the aim of the
21 foundations will be to liquidate the stock that they receive
22 to fund charitable activities?

23 A I believe that's their ultimate aim.

24 Q Would you agree with your investment banking consultants
25 that in order to achieve that aim, it is essential to have

1 an adequate public float?

2 A That's what I heard them say.

3 Q Is it not also your understanding, Mr. Odiorne, that to
4 assure an adequate public float that there must be a fairly
5 sizable IPO and that the foundations must - or at least
6 certainly may wish to share in the initial public offering?

7 A I believe that's what I heard them say.

8 Q With respect to the issues of rates in Eastern Washington, I
9 was struck by the comment in your testimony, Mr. Odiorne,
10 that you couldn't figure out what Premera was going to do
11 with its money, but you figured the first thing they were
12 going to do was make it possible to set different rates in
13 Eastern and Western Washington; is that right?

14 A I don't remember testifying like that.

15 Q Well, you said that there were system constraints that you
16 thought would be addressed that would have Premera moving
17 from statewide rating practices to more distinct ones; is
18 that right?

19 A I said there was that probability.

20 Q Is it your understanding, based upon Ms. Lee's testimony,
21 that if Premera were to use geographic factors in setting
22 rates in Eastern and Western Washington, the result would be
23 to reduce the rates in Eastern Washington and raise them in
24 Western Washington?

25 A I'm not sure that she said that absolutely would happen.

1 It's a possibility.

2 Q Are you familiar with the revenue neutrality rules that she
3 testified to?

4 A I have heard a lot about it in here.

5 Q You were not familiar before that point; is that correct?

6 A That's correct.

7 Q Do you have any reason to disagree with Ms. Lee's testimony,
8 or that of Ms. Halvorson, about the method in which - method
9 by which Premera may set rates for individual and small
10 group products?

11 A No.

12 Q With respect to the economic model by your PwC consultants,
13 Mr. Odiorne, am I correct in my understanding that your
14 target margins they were looking at there were target
15 margins that they had determined, not that Premera had
16 determined?

17 A I thought that they said that it was the target margins that
18 Premera had used.

19 Q Do you know why it was that those consultants looked at
20 target margins as opposed to top-line income, net income,
21 which are factors more important according to the investment
22 bankers?

23 A Just now, I don't remember why.

24 Q Were you at all troubled by the fact - by the fact that the
25 PwC consultants conceded that their model had no predictive

1 value?

2 A I think that it was presented not as a predictor.

3 Q Were you troubled by the fact that it had no regulatory
4 constraints in it, but rather assumed that there were no
5 such constraints?

6 A No, I wasn't troubled.

7 Q With respect to the insurance-buying public and your
8 concerns, Mr. Odiorne, I believe you said that Premera will
9 rely on growth in overall revenue and growth in membership
10 to grow its business and that those appear to be a stock
11 market emphasis rather than an insurance market emphasis; is
12 that right?

13 A I believe that I said that the focus seemed to be more on
14 the stock market shareholders than on subscribers.

15 Q Is it your understanding, Mr. Odiorne, that Premera's goal
16 is to grow a top-line revenue to increasing membership
17 irrespective of whether the conversion is approved?

18 A I don't remember that specific testimony.

19 Q Isn't that, in fact, the nature of the economic projections
20 that Premera had provided in the Form A?

21 A I believe it may be.

22 Q Can you explain to me, Mr. Odiorne, how it is that Premera
23 can grow its membership by disregarding the members in favor
24 of focusing on shareholders?

25 A I think it is possible to have a net growth in members in

1 which some members are lost. You pick and choose what is
2 the best group.

3 Q Don't you have to satisfy the insurance-buying public in
4 order to grow membership, Mr. Odiorne?

5 A To some extent, I think so, yes.

6 Q You referred - I think you alluded in your prior answer when
7 you testified more specifically to government programs as
8 being a source of concern in this area; is that right?

9 A Yes.

10 Q And you talked about Premera's getting out of certain
11 government programs and you inferred from that that
12 Premera - Premera was motivated by its desire to go public;
13 is that right?

14 A That was - yes.

15 Q Are we to infer from the fact that Regence and Group Health
16 exited the same products earlier that they are also planning
17 to go public?

18 A I don't know what they are planning to do.

19 Q You mentioned the decision to give up - by Premera to give
20 up its status as a Medicare Part A and intermediary. That's
21 not - doesn't have anything to do with the insurance-buying
22 public, does it?

23 A I think indirectly it does.

24 Q Well, Premera in serving as a Medicare intermediary is
25 merely providing administrative services for the government,

1 is it not?

2 A A local company providing local service, yes.

3 Q To the government, not with respect to the insurance-buying
4 public?

5 A The ultimate person served is the insurance-buying public.

6 Q Are you aware of the fact that the Illinois Blue plan, which
7 is nonprofit, has decided to exit the role of being an
8 intermediary under Medicare Part A?

9 A I have no familiarity with the Illinois Blue.

10 Q Are you familiar with the decision on the part of the
11 federal government to consolidate the number of
12 intermediaries that it uses?

13 A I am not aware of that.

14 Q Let's flip over, if we can, to the conditions you suggest,
15 Mr. Odiorne. One of the conditions that you suggest is
16 approval by the Washington Attorney General as to the plan
17 of diss- - dissolution and distribution of assets; is that
18 right?

19 A Yes.

20 Q Why do you think that the Attorney General must approve this
21 transaction?

22 A That was the advice that I received from counsel on it.

23 Q Are you aware of the fact that the Washington Attorney
24 General must approve only if there are assets in the plan of
25 distribution that are subject to charitable trust

1 restrictions?

2 A I have not researched that myself. I have relied on
3 counsel.

4 Q Would it not be more prudent for the Commissioner to not
5 presume the outcome of a decision to be made by the Attorney
6 General on whether or not approval is necessary?

7 A I would suggest that the Commissioner would - by including
8 it as a condition, would allow the Attorney General to do
9 whatever is necessary.

10 Q Well, if the Attorney General is not required by law to
11 approve the transaction, but has a power to disapprove it
12 under certain circumstances, would not the safer course be
13 to allow the Attorney General to exercise the authority
14 granted her by statute rather than to presume a decision yet
15 to be made?

16 A I'm not sure that I understand where you are going with
17 this. The - the condition would just say - would only be
18 applied if this transaction is approved and then it would
19 say when the Attorney General gets through with it, it can
20 go forward.

21 Q So what you are actually suggesting is that there not be a
22 disapproval by the Washington Attorney General; is that
23 right?

24 A No. What I'm saying is the Attorney General would do
25 whatever the Attorney General has to do.

1 Q But if the Attorney General isn't required to actually
2 approve the transaction, Mr. Odiorne, it is not appropriate
3 to require it as a condition of this approval, is it?

4 A Maybe I needed to clarify my condition and say that the
5 Attorney General has to do whatever the Attorney General
6 does.

7 Q I think we can agree on that one.

8 A Okay.

9 Q With respect to your suggested condition that there be a
10 fairness opinion with the Blackstone Group --

11 A Yes.

12 Q -- would you agree with me, Mr. Odiorne, that the fairness
13 opinion is not required by the Holding Company Act?

14 A I don't believe there is a specific requirement in the
15 Holding Company Act.

16 Q You had as one of your proposed conditions, receive an
17 approval for application for solicitation permit to issue
18 shares under the proposed executive compensation plan. Do
19 you recall that?

20 A Yes.

21 Q I think you may have misspoke. You were referring to the
22 equity compensation plan, were you not?

23 A It could be.

24 Q You only sell shares with the equity compensation plan; is
25 that your understanding?

1 A There would be shares transferred to executive compensation
2 and that's what would trigger the requirement for the
3 solicitation permit.

4 Q And given that the shares to be distributed under the equity
5 compensation plan are included within those to be
6 potentially distributed upon the IPO, a single solicitation
7 permit should suffice, should it not?

8 A I'm not sure that I understood it that way.

9 Q With respect to the suggested condition with regarding a
10 final opinion from E & Y, do I understand your testimony to
11 be that that opinion has been provided, but you await final
12 review of the technical memorandum that accompanied that
13 memo - I'm sorry - accompanied that opinion?

14 A It is my understanding that opinion referred to the
15 technical memorandum. The technical memorandum was not
16 filed here until late last week and I did not have a chance
17 to find out if the technical memorandum really supported the
18 opinion.

19 Q With respect to the remaining conditions, there are five of
20 them I detected that - Mr. Odiorne, that appear to relate to
21 requirements of the Blue Cross/Blue Shield Association. And
22 I'm going to tick them off, if I might, for you.

23 The proposed elimination of the requirement for the
24 foundations to sell down to 80 percent in the first year
25 after the IPO; the retention of a designated member until

1 the foundation has less than five percent stock ownership no
2 matter how long that takes; third, the requirement that
3 there be a separate divestiture schedule; four, that there
4 must be a separate five percent free vote; fifth, that there
5 must be a free vote on any transfer for issuance of stock
6 involving 20 percent or more of the equity of Premera.

7 You understand, do you not, that each of those five is a
8 specific requirement of the Blue Cross/Blue Shield
9 Association as it has been communicated to Premera in this
10 case?

11 A I don't know what the Association has talked to Premera
12 about in this case.

13 Q In saying that the Commissioner should approve this proposal
14 only with the five conditions I just enumerated --

15 A Mm-hmm.

16 Q -- each of which would require Premera to violate its Blue
17 Cross/Blue Shield license, are you saying that this
18 transaction should proceed only if Premera forfeits its Blue
19 marks in the process?

20 A I didn't say that.

21 Q Are you saying that the Commissioner should play chicken
22 with the BCBSA with Premera and its subscribers strapped to
23 the hood of the car?

24 MR. COOPERSMITH: Objection.

25 MR. HAMJE: Objection. Argumentative.

1 JUDGE FINKLE: Do you think it might be?

2 Q (BY MR. MITCHELL) Are you saying, Mr. Odiorne, that you
3 know these conditions are impossible and so it is just a
4 sham recommendation?

5 A I don't know that they are impossible.

6 Q Am I correct that in all of these recommendations regarding
7 these conditions, Mr. Odiorne, the welfare of Premera's
8 subscribers is irrelevant and your concern is maximizing the
9 value to the foundation?

10 A No.

11 Q Isn't this Mr. Cantilo's agenda rather than a statement of
12 what is set forth in the Holding Company Act, Mr. Odiorne?

13 A Those are what - what I think are conditions generally under
14 the Holding Company Act that would best serve the parties
15 that - to this transaction.

16 Q And it is the case, is it not, that this recommendation and
17 these specific conditions in particular are contrary to the
18 advice that you received from your investment banking
19 consultants as well as the testimony of Mr. Koplovitz,
20 Mr. Alderson-Smith and Mr. Lundy, among others?

21 A I'm not sure that all of these are contrary to anybody's
22 opinion.

23 Q They are consistent, however, with Mr. Cantilo's opinion; is
24 that right?

25 A Some of them may be, yes.

1 Q Are there any of them that you claim originality for,
2 Mr. Odiorne?

3 A I sorted these out from what I read and heard. I can't give
4 any one specific credit for any of them.

5 MR. MITCHELL: Nothing further. Thank you.

6 JUDGE FINKLE: Any Intervenors cross?

7 MR. COOPERSMITH: Just briefly, Your Honor.

8

9 CROSS-EXAMINATION

10

11 BY MR. COOPERSMITH:

12 Q Mr. Odiorne, good morning.

13 A Good morning.

14 Q The Premera lawyer just asked you whether the conditions
15 that you had recommended constituted a sham recommendation;
16 is that correct?

17 A That's what he asked.

18 Q But, in fact, it is your recommendation to reject Premera's
19 conversion proposal; is that correct?

20 A That's correct.

21 MR. COOPERSMITH: No further questions of this
22 witness at this time.

23 JUDGE FINKLE: Any other Intervenors cross?

24 MR. COOPERSMITH: No. No, Your Honor.

25 MS. McCULLOUGH: No, thank you.

1 MR. HAMJE: I just have a few on redirect.

2

3 REDIRECT EXAMINATION

4

5 BY MR. HAMJE:

6 Q Mr. Odiorne, what is it about Premera's specificity
7 concerning its plans for use of the proceeds of an IPO that
8 differs from what you have encountered in connection with
9 other companies?

10 A In other companies we have seen a more specific plan that
11 goes out a number of years. It's ordinarily a plan that is
12 rolled forward. The company addresses what they can and it
13 rolls forward. They add to it. They take off as they go,
14 but they do know what they are going to do.

15 Q You were asked during your testimony - testimony about
16 whether access to capital markets can be an advantage. Do
17 you recall that part of your - of the question?

18 A Yes.

19 Q For access to capital markets to be an advantage, what does
20 it depend upon?

21 A I think it depends a lot on what is going to be done with
22 that access, how it is going to be accessed, any
23 restrictions that may come with the access, a broad range of
24 issues within companies that will relate to that issue.

25 Q You were also asked about the economic assurances. Do you

1 recall that --

2 A Yes.

3 Q -- that part of your questioning?

4 A (Nods head.)

5 Q If the Commissioner approves the transaction with conditions
6 that incorporate the economic assurances, are you satisfied
7 with the two-year period that has been proposed in the
8 assurances?

9 A I really don't like the assurances to start with, but two
10 years doesn't provide much assurance.

11 Q Would you explain your answer about why you don't like the
12 assurances?

13 A Well, I think it has the potential of having an adverse
14 effect on Premera's financials because they are constrained
15 from doing certain things that a company ordinarily would do
16 in the market.

17 Q Mr. Odiorne, you were also asked questions about utilizing
18 an assumption with respect to a 50/50 split between the
19 foundations of the five percent that they utilize to vote
20 freely. Do you recall that - that question?

21 A Generally.

22 Q If each foundation has a free voting ability with respect to
23 five percent minus one of the shares of New Premera stock,
24 what effect would that have on nominating members to the
25 board of directors of New Premera?

1 A My recollection is that each of the foundations would then
2 have some ability to nominate. And if they are forced into
3 splitting one five percent share, then they don't have that
4 ability.

5 Q You were also asked about Premera growing membership and
6 then you also talked about losing members. Do you recall
7 that testimony and that question?

8 A Yes.

9 Q What kind of members are you talking about when you are
10 talking about losing members?

11 A The ones we have seen losing are those that are high-priced,
12 that cost a lot, that don't return a profit.

13 Q Can you give me some examples of that?

14 A There is testimony that they gave up the state contract
15 because it would be a loss. The government contracts
16 generally have been loss leaders for companies. They get
17 rid of them. The associations, generally, if they are not
18 returning profit, are not renewed.

19 Q If the Commissioner were to attach conditions to the
20 approval that if accepted by Premera could place the Blue
21 mark at risk, what could Premera do at that point?

22 A Choose not to convert.

23 MR. HAMJE: That's all I have.

24 MR. MITCHELL: Quick follow-up, Mr. Odiorne.

25

RECROSS-EXAMINATION

BY MR. MITCHELL:

Q With respect to the five percent block and the right to
nominate, is it not the case under the terms of the Amended
Form A proposal that each of the foundations is given the
right to nominate a designated member of the Premera board?

A I believe that there was some nomination, yes.

Q Indeed, isn't it the case that persons so nominated are
designated automatically to serve on key committees on the
Premera board of directors?

A Yes.

MR. MITCHELL: Nothing further.

MR. COOPERSMITH: Nothing further, Your Honor.

MR. HAMJE: Nothing further.

MR. COOPERSMITH: Pardon me. The Alaska
Intervenors --

MS. McCULLOUGH: I just have one. I'm sorry. I
just have one question.

CROSS-EXAMINATION

BY MS. McCULLOUGH:

Q Regarding the nominations, is it your understanding that Premera has complete veto power over those nominations to the board?

A Currently, yes.

MS. McCULLOUGH: Thank you.

JUDGE FINKLE: Any follow-up?

MR. HAMJE: None.

EXAMINATION

BY COMMISSIONER KREIDLER:

Q Mr. Odiorne, one of the items that came up was relative to the jeopardy of the Blues marks. Not to use Mr. Mitchell's analogy, but it dealt with the question about how hard and fast the rules are for the Blues Association. And we heard in testimony - and specifically to Maryland - from Cantilo and Mr. Larsen what took place in the State of Maryland.

Do you look at - at what is presented to us as the agreement right now to be a hard and fast rule or is it, in fact, somewhat of a moving target and negotiable?

A As I understand it, what we are dealing with isn't written and it has not been approved by the Association so far, so

1 there is still the possibility that once you enter your
2 order, they still have to go back to the Association to see
3 if the Association agrees with it.

4 Q I'm curious on another issue that came up. I believe it was
5 Mr. Cantilo that pointed it out, that the restraints that -
6 as we understand them, yet to be approved - well, actually I
7 think this may have been approved at least in the case of
8 WellPoint relative to the five and ten percent ownership
9 either by individual or by group --

10 A Yes.

11 Q -- that that rule does not apply to the Blues Association
12 members. Were you aware of that?

13 A That was my understanding, yes.

14 Q Could that theoretically lead them to an Anthem or a
15 WellPoint as public companies effectively take ownership
16 shares that would essentially mean control of Premera?

17 A I think in theory it could.

18 Q I'm curious, if a - if a conversion were to be approved so
19 we were essentially seeing a not-for-profit company
20 converted to a public company and that is under the
21 submission of a Form A filing with the Office of the
22 Insurance Commissioner, what differences in standard would
23 you imagine would apply if subsequently another Form A were
24 filed sort of as a public company merger acquisition to
25 another public company as to the standards that would be

1 applied under the Form A - Form A authority?

2 A I think the same statutory standards would apply. Once we
3 know that we have got all the little details out of the way
4 in the conversion - there are details about how much assets
5 are transferred to whom -- then that is off the plate and
6 you have two companies that, in theory, don't have those
7 kinds of restrictions and it is a simplified process to go
8 through, but the same statutory standards would apply.

9 Q So arguably, it would be easier to make the move from a
10 public company to a public company as opposed from nonprofit
11 to a public company?

12 A Yes.

13 COMMISSIONER KREIDLER: Thank you very much. No
14 further questions.

15 JUDGE FINKLE: Follow-up?

16 MR. HAMJE: No follow-up.

17 MR. MITCHELL: No.

18 MR. COOPERSMITH: None from the Intervenors,
19 including Alaska.

20 JUDGE FINKLE: Okay. Let's take a break. Please
21 step down.

22

23 (Brief recess.)

24

25 JUDGE FINKLE: Ready to proceed?

1 MR. MITCHELL: Premera will call John Steel.

2 JUDGE FINKLE: Please go ahead and sit down. You
3 are still under oath.

4

5

6

DIRECT EXAMINATION

7

8 BY MR. MITCHELL:

9 Q Mr. Steel, have you reviewed Mr. Cantilo's testimony given
10 in this proceeding last Friday?

11 A Yes, I have.

12 Q In his testimony on Friday, Mr. Cantilo said his assumption
13 about transferring fair market value to charity did not rest
14 on the assumption that Premera is currently a charity or
15 that its assets are owned by the public. Do you agree?

16 A Well, I think that's a bit of revisionist history. I think
17 Mr. Cantilo's reports and his deposition are containing
18 numerous references to assumptions that there is a
19 charitable trust and, to his belief, that Premera and its
20 assets are owned by the public.

21 Had those references not been in there, I would not have
22 spent nearly as much time addressing those issues in my
23 report, in fact. But I believe what has happened now is
24 that Mr. Cantilo, as well as Mr. Odiorne, have moved away
25 from that assumption.

1 Q In his testimony, Mr. Cantilo offered the view that you are
2 in agreement with his interpretation of Washington law as to
3 what the nonprofit corporation statute requires,
4 particularly relative to transfer of the fair market value
5 of Premera's assets. Do you agree with Mr. Cantilo's
6 characterization?

7 A Well, certainly he and I are, I believe, closer in our
8 beliefs now that he has moved away from the assumption that
9 there is a charitable trust. However, I continue to
10 disagree very strongly with his belief that there is an
11 obligation of the transfer of fair market value or that
12 the - or that there is a requirement that assets be
13 transferred free of restrictions.

14 Q Can you elaborate, please, on why you believe there is no
15 fair market value concept inherent in the nonprofit
16 Washington corporation statute?

17 A Yes. I think for starters, it is important to - to note
18 that even though Mr. Cantilo, I believe, implies that this
19 is something that arises uniquely under the not-for-profit
20 corporation statute, the reality is that the language of the
21 distribution section of the not-for-profit corporation
22 statute that have to do with paying off your creditors and
23 distributing your assets are virtually identical to the
24 similar wording that is found in the for-profit corporation
25 statute. In other words, there isn't - this isn't is a

1 concept that is unique to the not-for-profit corporation
2 statute.

3 Secondly, the not-for-profit corporation statute, as
4 well as the for-profit corporation statute, has no reference
5 in it to fair market value. Mr. Cantilo acknowledges this
6 and - but chooses to ignore it. The only reference under
7 Washington statutes to fair market value in this kind of a
8 context appears in Chapter 70.45, which is the
9 not-for-profit hospital acquisitions statute.

10 And as I elaborated on in my report, that statute, I
11 believe, is - well, one, completely inapplicable to Premera
12 and inapplicable in this hearing. But more importantly, the
13 effort to import that fair market value concept from that
14 statute into this proceeding is completely inappropriate in
15 light of the fact that Washington legislature basically
16 rejected applying such a standard to healthcare insurers in
17 Washington.

18 And then third, this notion that assets are legally
19 required to be transferred free of restrictions is - not
20 only has no basis under the statute or in any case law, but
21 in addition, it is completely out of step with reality. The
22 fact is that many corporations in a dissolution setting,
23 whether they are for-profit corporations or not-for-profit
24 corporations, do transfer their assets with continuing
25 restrictions attached to them. And the reason that they do

1 this is because it may be necessary to have some continuing
2 restrictions attached in order to preserve asset value or to
3 improve the liquidity of the assets that are being passed
4 on.

5 Examples of this would include, for example, a company
6 that holds a business - an operating business might wish to
7 transfer assets to some designated person, but, you know,
8 they have a choice of transferring the assets with all of
9 the lingering contract obligations and whatnot that go along
10 with the business or without.

11 If they transfer it without, really all they are
12 transferring are the tables and chairs. And the going
13 concern, value is lost. So, you know, there - there may
14 well be a decision to transfer the assets with lingering
15 obligations in order to preserve value.

16 In the current case, I believe that the reason that the
17 Premera board has proposed that there be lingering
18 restrictions is really for both of those purposes that I
19 cited, first to preserve value. And that really comes up in
20 the case of attempting to be sure that the BCBSA license -
21 which everyone has characterized as kind of a crown jewel
22 asset - not be lost in this process. And secondly, so that
23 the shares that are passed on to the foundations be put on a
24 path to liquidity so that those assets, when transferred,
25 actually are a value to the foundations.

1 Q Do you see any different result under Premera's articles of
2 incorporation which were cited by Mr. Cantilo?

3 A No, I don't. There is no language in the articles that
4 would suggest either a fair market value requirement or a
5 requirement that assets be transferred without restrictions.

6 Q What would happen if you attempted to transfer the stock
7 without any restrictions as suggested by Mr. Cantilo?

8 A Well, I think if the assets were transferred completely free
9 of any restrictions, I believe there would be a reduction of
10 value rather than an augmentation of value, as he suggests.

11 The reason I say that, first, you would lose the BCBSA
12 license, which everyone seems to agree would be a quote,
13 disaster. It certainly would reduce the value of the
14 company.

15 And secondly, the - the ability of the foundations to
16 get liquid on that stock would be reduced because none of
17 the assurances that underwriters would expect from the major
18 shareholders would be in place.

19 Q Mr. Cantilo further testified on Friday that one basis for
20 his belief that Premera is obligated to transfer fair market
21 value to the foundation is it is Premera's agreement to do
22 so. Do you see any evidence of such an agreement in the
23 Form A or Amended Form A documents, Mr. Steel?

24 A No, I do not.

25 Q What is your view of the argument by Mr. Cantilo that the

1 letter dated October 15th, 2003, which is Exhibit P-221,
2 part of which is Exhibit S-6, from Premera's counsel to the
3 OIC concerning errors in the consultants' draft reports
4 constitutes an agreement or a representation that Premera
5 would transfer fair market value of its assets?

6 A Well, basically I believe that there is really no basis for
7 anyone to infer from that letter that there is an agreement
8 to transfer fair market value.

9 In fact, if you look at the paragraph in question that
10 they cite, the whole purpose of that paragraph is to
11 explicitly deny that there is any, quote, apparent
12 agreement. That is the purpose of the paragraph, so I don't
13 know how you can infer from that paragraph that there is an
14 agreement.

15 Secondly, if you look at the purpose of the whole
16 letter, the whole memo, it is to defend the terms of the
17 Form A filing, which of course have in it - within the terms
18 of the Form A filing are the very conditions and
19 restrictions that are being complained of. So I think it is
20 pretty much impossible to look at that letter as a
21 concession that those restrictions are - you know, are not
22 going to be applicable.

23 MR. MITCHELL: May I approach, Your Honor?

24 JUDGE FINKLE: Yes.

25 Q (BY MR. MITCHELL) Mr. Steel, I have handed you what has

1 been previously admitted as Exhibit 132, an e-mail from
2 Mr. Taktajian to Mr. Cantilo dated October 16th, 2003. Is
3 there anything in this e-mail that further supports the
4 conclusion you just stated?

5 A Yes. The conclusion I just stated was that I don't believe
6 that there is any way you can read the letter from Premera
7 counsel as an agreement basically to transfer fair market
8 value. And what this e-mail here addresses to that is that
9 it really tells me two things: One is at the beginning of
10 Paragraph 3, they are talking about - Mr. Taktajian is
11 talking about fair market value as referred to in the
12 comments from Premera's counsel and his comment to
13 Mr. Cantilo is, "At the time you inserted this language" -
14 meaning the fair market value language - "you had mentioned
15 that this would be a point of contention."

16 So the first thing I draw out of this is that even
17 before Cantilo & Bennett published their preliminary report
18 in which they took the position that they thought it was
19 agreed that - that fair market value would be transferred,
20 even before they made that statement in their preliminary
21 report, they knew that Premera didn't agree with it.

22 The other, and maybe even more important, thing that
23 this e-mail tells me is that even after the letter from
24 Premera's counsel in which he stated that Premera certainly
25 continues to take issue with that proposition. This e-mail

1 recognizes that - that Cantilo & Bennett - Taktajian and
2 Cantilo still understand that it is a point of contention
3 and they start thinking of well, gee, maybe there is other
4 ways we can try to attack the problem.

5 Q Did Mr. Cantilo acknowledge the very same thing in his
6 deposition testimony?

7 A Yes. He acknowledged his awareness that it was a point of
8 contention.

9 Q And, Mr. Steel, I have put up Page 304 from the Exhibit
10 P-113. Is that the passage in Mr. Cantilo's deposition
11 testimony to which you have just referred?

12 A Yes, it is.

13 Q Recognizing, Mr. Steel, that you see no basis in Washington
14 law in the Form A - the Amended Form A or the October 15th,
15 2003, letter from Mr. Cantilo, the assertion that Premera is
16 obligated to transfer the fair market value of its assets to
17 the foundations, if nonetheless I were to ask you to assume
18 that there is such an obligation to transfer fair market
19 value, do you have an opinion as to whether the proposed
20 conversion would satisfy that assumed requirement?

21 A Yes. I believe that it would satisfy that assumed
22 obligation. The reason I say that is that I believe that
23 these restrictions that we are talking about will, on the
24 whole, enhance the value of the shares in the hands of the
25 foundations. They will provide a means by which those

1 shares can become liquid. They will optimize the price and
2 minimize the dilution in the public offering. And they will
3 provide sufficient comfort that the public market is
4 receptive to continued selling activity by the foundations.

5 Q Mr. Cantilo indicated that Premera did not meet its duties
6 insofar as it failed to explore a sale of the company when
7 it was looking at capital raising alternatives. Do you
8 agree?

9 A No, I do not. I covered this issue at some length in my
10 original report. And without going into all the detail
11 here, let me just say briefly that a company that is looking
12 at ways of raising capital or improving its capital base is
13 not obligated to put the company in play. I mean, there is
14 just no legal basis for that assertion.

15 And once you understand that principle, if you look at
16 what the Premera board actually did here and the way that it
17 looked at not only capital raising alternatives but actually
18 a much wider variety of strategic alternatives, they
19 actually did more than they really were required to do by
20 law.

21 MR. MITCHELL: Thank you very much. Nothing
22 further.

CROSS-EXAMINATION

1

2

3 BY MR. HAMJE:

4 Q Good morning, Mr. Steel.

5 A Good morning.

6 Q I understand you believe that Premera is not obligated to
7 transfer the fair market value of its assets upon
8 dissolution to the foundation; is that right?

9 A Yes.

10 Q Would you agree with me that Premera is not prohibited from
11 doing so?

12 A I don't know that the fair market value analysis comes into
13 play one way or another.

14 Q Would you please answer my question?

15 Again, would you agree that Premera would not be
16 prohibited from transferring the fair market value of its
17 assets upon dissolution to the foundation?

18 A I agree with that.

19 Q With respect to the Form A and other Premera Blue Cross
20 documents, Premera Blue Cross has said that it will - that
21 it is transferring 100 percent of its assets to the
22 foundations; is that correct?

23 A I believe it is said it is transferring 100 percent of its
24 stock of New Premera.

25 Q But not 100 percent of its assets? You don't recall it

1 saying that anywhere?

2 A I don't.

3 Q Does it make a difference to you, 100 percent of stock
4 versus 100 percent of assets?

5 A Probably not.

6 Q Under what circumstances would it make a difference?

7 A I don't have one in mind. I said probably not.

8 Q Currently there are no restrictions on Premera's assets
9 today that you know of?

10 A Well, I think there are a lot of restrictions on Premera's
11 assets. There are always a lot of restrictions on the
12 assets of an operating business.

13 Q Can you give me an example?

14 A Well, there is always a load of ongoing operating contracts,
15 leases, loans, security interests. In this case, one of the
16 most obvious ones is the BCBSA license, which has many
17 restrictions in it.

18 Q To your knowledge, has the Blue Cross/Blue Shield
19 Association approved Premera's proposal?

20 A I have no idea.

21 Q If the Commissioner were to attach conditions to the
22 approval that if accepted by Premera could place the Blues
23 mark at risk, what could Premera do at that point?

24 A Are you asking what - what regulatory alternatives? I mean,
25 I'm not really qualified to speak on that.

1 Q What action could Premera take in that situation?

2 Do you want me to repeat the question?

3 A Please.

4 Q If the Commissioner were to attach conditions to the
5 approval that if accepted by Premera could place the Blues
6 mark at risk, what could Premera do at that point?

7 A Well, I have no idea what their administrative remedies
8 might be. Beyond that, the only other alternatives that I'm
9 aware of is that they would have to make a decision whether
10 to proceed forward without the Blue mark or else back off of
11 the application.

12 Q Is it also possible that Premera could enter into further
13 negotiations with the Blue Cross/Blue Shield Association to
14 develop a mutually acceptable agreement with the
15 Association?

16 A Again, I have zero visibility into what has already happened
17 with the Blue Cross/Blue Shield Association, so I don't know
18 whether that is realistically possible or not.

19 MR. HAMJE: That's all we have. Thank you, sir.

20 THE WITNESS: You're welcome.

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CROSS-EXAMINATION

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BY MR. MADDEN:

Q Good morning, Mr. Steel.

A Good morning.

Q Is it your testimony that, accepting the premise for the moment that Premera's assets are not subject to any charitable restrictions, that the only restrictions on distribution of assets upon dissolution of the current not-for-profit are the restrictions stated in its articles?

A Basically that is all I'm aware of.

Q Okay. And - and those articles are subject to amendment, are they not?

A They are.

Q Premera chose not to amend its articles in connection with the proposed conversion transaction; is that also correct?

A Correct.

Q Now, taking the logic of your testimony, it seems to me - correct me if I'm wrong - that you are saying that the Commissioner should evaluate the effect of this transaction on the insurance-buying public without regard to the transfer of stock to the foundations because, after all, that's purely a voluntary gift on the part of Premera?

A I don't believe I have ever commented on exactly how the Commissioner ought to review things. I have only commented

1 on the law.

2 Q And under your view of the law, the benefits, if any, to the
3 public that would result from this gift of stock are
4 irrelevant to his inquiry?

5 A No, I'm not saying that. I'm just saying I don't - I have
6 not even attempted to consider the benefits to the
7 insurance-buying public. That is not a part of what I have
8 looked at.

9 Q All right. To carry this a little bit further, the logic of
10 your opinions would seem to suggest that the Attorney
11 General should not disapprove this transaction; correct?

12 A I believe that the Attorney General does not probably have
13 any power to disapprove this transaction.

14 Q She lacks jurisdiction, in your opinion?

15 A Well, I wouldn't - I don't know if I would say that. But I
16 believe there are no charitable assets here, at least none
17 have been shown.

18 Q And, finally, did I hear you say at the outset of your
19 direct testimony that you are accusing the OIC staff of
20 engaging in revisionist history?

21 A I believe I used those words relative to Mr. Cantilo.

22 MR. MADDEN: Thank you. No further questions.

23 JUDGE FINKLE: Other Intervenors?

24 MS. McCULLOUGH: No, thank you.

25 MR. MITCHELL: No redirect.

1 MR. HAMJE: No further cross.

2
3 EXAMINATION

4
5 BY COMMISSIONER KREIDLER:

6 Q Mr. Steel, perhaps you could help me in understanding the
7 difference between fair market value and - and what would be
8 100 hundred percent of the initial stock offering. Do you
9 see a difference in the value between those two issues, fair
10 market value and 100 percent of the initial stock offering,
11 valuewise?

12 A Not really, no. The point I was attempting to make in my
13 testimony is that even if there were some slight difference,
14 I don't think that that is legally very important.

15 Q So potentially 100 percent of the initial stock offering in
16 your opinion and the fair market value might be comparable?

17 A Well, yeah. I mean, normally I would think of a person who
18 owns 100 percent of a corporation that the moment it is seen
19 public is - you know, whatever the fair market value is at
20 that moment, I would think that they own that.

21 Q If, in fact, that is the same, perhaps you can help me to
22 understand the reservations from determining that there is a
23 charitable trust as opposed to 100 percent of the initial
24 stock offering.

25 What is the legal concern that seems to be so

1 contentious as determining whether it is a charitable trust
2 or not and the issues of fair market value transfer and
3 certainly what then is made available to the foundations?

4 A Well, the legal concern is, as I understand it - again, this
5 is originating from the - the OIC consultants - is that they
6 believe for whatever reason - whether it is based on
7 charitable trust, theory or the idea that there is an
8 agreement, they believe that there is an obligation on
9 Premera to convey fair market value. And then with that
10 conclusion in mind, then they look at these various
11 restrictions and draw the conclusion that these restrictions
12 surely must detract from fair market value.

13 This is a reason that I was pointing out earlier that I
14 think the reality of the situation is that these
15 restrictions actually enhance fair market value rather than
16 detract.

17 Q So - so the discussion dispute on charitable trust centers
18 solely on the restrictions that would be placed on the
19 foundations' control of the stock?

20 A That - that appears to be where the skirmish is occurring,
21 yes. Yes.

22 Q That's helpful to me to understand just exactly why that
23 is - appears to be so much a point of contention since if,
24 in fact, the 100 percent of the value - 100 percent of the
25 initial stock offering and fair market value are close to

1 the same.

2 If, in fact, it is - it is fair to assume hypothetically
3 that Premera has an obligation to transfer the - 100 percent
4 of the fair market value to the foundations, couldn't there
5 still be restrictions agreed to for the very reasons that
6 you described, that it may actually be in the foundations'
7 interest?

8 A Yes. And I think, you know, in my earlier testimony I gave
9 an example of spin-off situations where a parent company
10 that owns 100 percent of the stock at the moment of IPO will
11 agree to those restrictions because they view it as being in
12 their own self-interest, as enhancing the value they hold.

13 Q Very good. Thank you very much.

14 COMMISSIONER KREIDLER: No further questions.

15 MR. HAMJE: None here.

16 JUDGE FINKLE: Intervenors?

17 MR. MADDEN: None here.

18 JUDGE FINKLE: Thank you. Please step down.

19 MR. KELLY: We will call Mr. Barlow in rebuttal.

20 JUDGE FINKLE: Please take the stand, Mr. Barlow.

21 You are still under oath.

22 MR. KELLY: While he is settling in, since we'll be
23 referring to Page 3 of Exhibit P-90, I ask that it be
24 displayed on the overhead.

25 You all set?

1 THE WITNESS: (Nods head.)

2
3 DIRECT EXAMINATION

4
5 BY MR. KELLY:

6 Q In his direct testimony, Mr. Odiorne suggests that Premera
7 had not adequately described or explained what would happen
8 to the proceeds of the IPO. What is your response to that?

9 A Well, I believe that we have been extremely clear as to how
10 we ought to apply the proceeds. Our goal is to increase the
11 risk-based capital of the company from its existing
12 approximately 433 percent to something closer to what is now
13 the average of the Blues, which is 712 percent.

14 So our objective is to increase risk-based capital by
15 issuing shares thereby getting cash. But obviously the
16 other side of the transaction is to increase the capital
17 surplus of the corporation that will - and we want to do
18 that to about 150 million dollars.

19 That would increase, by a recent calculation, our
20 risk-based capital to about 600 percent, which we think
21 brings us to an acceptable level for three primary reasons.

22 The first reason is to protect us against economic
23 uncertainty. So we are strengthening the capital reserve,
24 which obviously is there to meet the needs of our members
25 into the future. So that's the first purpose, strengthen

1 the capital of the company.

2 By doing that, it also gives us, Commissioner, the
3 ability to grow. We think growth is very good because it
4 obviously meets the needs of all those new members who
5 bought our product. It also gives us the risk-based capital
6 to grow our members and therefore to be able to continue to
7 invest in programs that are desirable to existing members
8 and to new members that we bring on into the future.

9 The issue of - the issue of the use of proceeds implies
10 that somehow we are cash-constrained. That is not the
11 issue. The issue - we have got about between 700 and 800
12 million dollars of cash or investments on our balance sheet
13 today. That is irrelevant. The relevant statistic for us
14 is how much capital do we have. And that's what needs to be
15 increased.

16 And issuing by 150 million dollars, we will increase our
17 cash and investments and most importantly we will increase
18 the capital reserves of the company to be able to do these
19 other things.

20 Q Were you present during the testimony of Mr. Smit about the
21 variety of activities that he has in regard to
22 infrastructure, products and services?

23 A Yes, I was.

24 Q Let me turn to another subject. Mr. Odiorne suggested a
25 concern - used the phrase "entrenchment of management" in

1 his testimony yesterday. What do you have to say about his
2 observations there?

3 A Well, as I made clear, Commissioner - and I think you would
4 understand this - I serve at the pleasure of the board and
5 so does the executive management and, by extension, all of
6 management serves at the pleasure of the board. So to
7 suggest that this is somehow entrenching management just
8 doesn't coincide with the reality of the fact that I'm
9 employed by the board.

10 A management group that is seeking to entrench itself
11 would hardly want to go public where its performance is
12 going to be closely monitored by the public markets out
13 there to an extent that it has never experienced in the past
14 and, therefore, highlight to the board, if it should - so if
15 there is any failure in that management of the company,
16 those sorts of things, they will take action to get rid of
17 the management team. This happens frequently. It is a
18 function of the marketplace.

19 So to imply that somehow this is entrenching us just
20 doesn't square with the reality of what I understand the
21 public markets do.

22 Q Mr. Odiorne also expressed a concern about what he described
23 as - and I think I'm quoting him correctly - quote,
24 "Premera's apparently overriding desire to maintain local
25 control," end quote.

1 My questions to you are, first of all, does that
2 accurately describe Premera's position about local control
3 and, if not, what is Premera's position?

4 A That does not accurately describe. My opinion and the
5 opinion of the board as to the - this desire around local
6 control goes to the service of our mission. It is an ending
7 of itself.

8 We believe that our mission of providing peace of mind
9 to our members about their healthcare coverage is best
10 served through local management who can be in touch with the
11 market and make local decisions and be more flexible to
12 respond to the needs of the marketplace.

13 But it is not an ending of itself. This autonomy has to
14 be valued by the marketplace, too. So as long as it is
15 serving the membership, which we believe it does, then
16 that's where we believe we should be. If it doesn't serve
17 the mission, because our members don't value it, then
18 obviously we have to go in a different direction.

19 Q Let me turn to another area. A number of the Intervenor's
20 witnesses seem to have the belief that nonprofits behave
21 differently than for-profits. What do you have to say in
22 response to that?

23 A Once again, for-profits and not-for-profits have to work
24 under the laws of economics, under the reality of the
25 marketplace, and I see very little difference between the

1 way for-profits and not-for-profits behave today.

2 And it was alluded to yesterday by Richard Peterson, who
3 is in a different line of business, but related in the
4 hospital area - he is the CEO of Swedish Hospital, as I'm
5 sure you are aware - has stated that not-for-profit is a
6 misnomer. And to quote him, "And to say it is a bit of a
7 misnomer, Swedish," he said, "must operate as a business, to
8 earn the profit it needs to grow, expand and replenish
9 facilities and technology. It grows or perishes," Peterson
10 said. That is a quote from this week's Puget Sound Business
11 Journal.

12 Sounds pretty much like what we are saying, doesn't it?

13 Q Now, what about the claim that Premera has been shedding
14 unprofitable lines of business for sometime supposedly in
15 preparation for conversion? What do you have to say about
16 that?

17 A Well, once again, that doesn't square with the facts. When
18 I joined the company in 1997 - I can only speak from that
19 time forward - we - the attitude of the company was every
20 line of business should pay for itself, perhaps not
21 immediately, but you must have a vision as to how every line
22 of business is going to pay for itself.

23 And in 1997, long before a conversion to for-profit was
24 even considered or on the table, we exited the PEPB PPO
25 product for Blue Cross. We went in some PEPB I believe for

1 MSC and for HealthPlus, which was our HMO product at the
2 time, but we exited a large chunk of business in 1997. At
3 the same time, we also exited counties in - that we were
4 providing coverage under the Basic - the Basic Health Plan
5 and the Healthy Options.

6 But we weren't alone in doing that. The other for - the
7 other not-for-profits in the state, the large ones, being
8 Group Health and Regence, also exited several counties
9 providing coverage in 1997 or thereabouts in the Basic
10 Health Plan and Healthy Options. So this is long before
11 conversion was contemplated.

12 In 1998, we stopped selling in the individual market.
13 Soon after that we were followed by nonprofit Regence and
14 Group Health. So to imply somehow that this is a link to
15 conversion just doesn't square with the reality of happened.

16 And I can say that the Medicare Part A decision was,
17 once again, totally separate, but it gets closer to the time
18 so you can start to imply a conclusion that clearly doesn't
19 apply to that earlier time. But just to be clear on it -
20 when we looked at the Medicaid Part A, we chose to exit that
21 whether or not we convert because we don't believe it is a
22 line of business that is good for Premera or our
23 subscribers.

24 Q When Mr. Greenawalt was talking about the issues for the
25 hospitals, wasn't he really echoing what you were saying by

1 indicating no mission, no margin?

2 MR. MADDEN: Objection to the form of the question.

3 JUDGE FINKLE: Sustained.

4 MR. KELLY: I will withdraw.

5 Q (BY MR. KELLY) What about the claim that after conversion,
6 Premera will be focusing exclusively on satisfying
7 shareholders?

8 A Well, once again, that just doesn't square with the
9 realities of the marketplace. If we serve our members well
10 and that service is valued by our members, we will provide
11 the optimal value to our stockholders and they will value
12 that, too. If we don't have members, our stockholders are
13 going to be extremely dissatisfied, so the two are not
14 mutually exclusive. In fact, they are supportive of each
15 other.

16 Q Okay. Mr. Odiorne suggests that the conversion might lead
17 to Premera's loss of its 833(b) deduction in regard to the
18 marginal tax rate issue that was discussed this morning and,
19 therefore, he appears to conclude that such a loss might be
20 grounds for not approving the conversion. How do you
21 respond to whatever it is he is saying there?

22 A Well, there are a number of factors there and I think he
23 linked it to some of the financial stability of the company.
24 In the first instance, Ernst & Young has given us an opinion
25 that says more likely than not, more than a 50 percent

1 chance, we will retain the 833(b) deduction that we are
2 benefiting from, even postconversion.

3 Secondly, we have net operating losses that should the
4 833(b) deduction be lost, we will still benefit from the net
5 operating loss deduction, which will partially offset the
6 loss of the 833(b), not completely, but partially.

7 And then, thirdly, and I think most importantly,
8 Mr. Odiorne ignores the fact that the whole purpose of
9 conversion is to strengthen our balance sheet immediately
10 versus some tax deduction that we are going to experience
11 over a period of time. So to imply that somehow we weaken
12 the company just doesn't square, once again, with what seems
13 to me to be the reality of the situation.

14 I also have to say, again, in line with the
15 cross-examination that I heard of Mr. Odiorne, how would any
16 conversion of a not-for-profit to a for-profit be approved
17 under that standard? Because almost every instance that I
18 know of, taxes do get changed and start to be from - going
19 either from partially tax shielded to fully taxed or from
20 non - totally nontaxed to fully taxed. And in that case,
21 how could any of these other conversions be approved?

22 Q Let me turn to another area. That's the Blues requirement.
23 Mr. Odiorne enumerated a number of conditions that he was
24 proposing that are related to the Blue Association
25 requirements. What would be the impact of making those a

1 part of the conversion?

2 A Well, Commissioner, I just reiterate what I said earlier in
3 my previous testimony. The Blues have - have not taken a
4 position whether to approve or disapprove conversions. They
5 have made the option available to the member plans to
6 convert. What they have done with that, though, is to say
7 that the Blues Association's primary objective is to protect
8 and enhance the Blue brands.

9 They believe that having shares owned - and they set the
10 rule that shares should not be owned more than five percent
11 by individuals and nonfinancial institutions and not more
12 than 10 percent, so that's the rule. And they expect
13 companies that convert to comply with that.

14 They have made exceptions to that rule that have been -
15 so there is a lot of precedent of exceptions, which are
16 available, that have to be approved by the Association. And
17 so if we are to maintain our license, they have to agree to
18 the exceptions that would be made.

19 Now, I believe that we can get them to the level of the
20 exceptions that have been agreed to in the WellChoice, which
21 was the nearest conversion to ours - to our proposed
22 conversion.

23 As you know, we did go back and argue the case. In
24 fact, we invited Mr. Cantilo and, I believe Mr. Odiorne as
25 well, to come with us to meet with the Association to talk

1 about the dual foundation rights that have been much
2 discussed in this case and they chose not to come.

3 But be that as it may, we have made our case to the
4 Association and committee that really has the most say in
5 this, the Plan Performance Financial Standards Committee.
6 And they have agreed to one additional exception. So it is
7 not completely blind to other requirements and other states.
8 And that exception was that they have agreed to recommend to
9 the full board to allow us to have a director representing
10 the Washington foundation and a director representing the
11 Alaska foundation separately, but they did not agree to the
12 other two.

13 And so I don't know if Mr. Cantilo implied that because
14 I'm one of 42 board members, that I have a lot of influence.
15 Well, obviously, one in 42, that adds up to just about over
16 two percent. And it is hard to convince a body as large as
17 that that your particular requirements should be given -
18 given additional requirements - I'm sorry - exceptions as
19 has previously been granted.

20 Q Did you do your best to persuade them, though?

21 A We did our best. I don't know how we could have done a
22 better job. The case was articulated, I think, very well in
23 my prefiled testimony, which I'm sure you have read. And it
24 is set out pretty well there. We argued the case in person.
25 We went back east. Myself and Mr. Domeika and Mr. Milo went

1 back east to argue the case before the PPFSC and the result
2 is as it is known.

3 Q One final area of questioning I have is in regard to
4 Mr. Greenawalt's concern about the difficulties that
5 hospitals face. Would you comment on whether and how
6 Premera recognizes that hospitals and physicians often
7 provide uncompensated care?

8 A I - I believe that physicians and hospitals do render
9 uncompensated or undercompensated care. It is pretty
10 readily apparent when you look at the rates that are paid
11 for Medicare and Medicaid relative to the commercial market.
12 We pay much more. So we recognize that - that there has to
13 be some kind of a cross-subsidization of the government
14 programs.

15 It's effectively a hidden tax on our members. This is
16 recognized by Premera, the other nonprofits and the
17 for-profits. We all pay in the similar line.

18 So we are very sympathetic. It doesn't mean, of course,
19 that there won't be some tension in the negotiation when we
20 negotiate the specific rate that is to be paid to each
21 hospital and to physician groups. We want to get the best
22 deal that we can to make the insurance as affordable as we
23 can for our members while still providing the broadest
24 networks that we can given the constraints of the
25 marketplace.

1 Q Is that going to change, again depending on whether you are
2 for-profit or not-for-profit?

3 A It absolutely won't. And it applies today. The same
4 constraints apply today to the for-profits as apply to the
5 not-for-profits. I think we are all trying to do the same
6 thing in different ways.

7 Q Now, have there been instances where Premera has come to the
8 aid of a hospital that was crucial to its network?

9 A Well, the most important exception recently that I - example
10 that I can give recently is the Empire system in Spokane,
11 Deaconess Hospital, being the major hospital, came to us mid
12 contract. We had a contract for the year lying out what the
13 rates would be. In fact, I think we had a contract to run
14 for another 18 months at that time. I don't recall exactly.

15 All I know is that we may - we agreed to increase - mid
16 contract - a contracted rate - because they were struggling
17 to make ends meet. We have an interest in them remaining
18 viable and surviving in the marketplace because that's an
19 interest of our members. So we wanted them to be as strong
20 as is reasonable for them to be so that they can continue to
21 provide hospital services to our members.

22 Q Okay.

23 MR. KELLY: Excuse me for a minute.

24 That's all I have on direct. Thank you.

25

CROSS-EXAMINATION

BY MR. HAMJE:

Q Good morning, Mr. Barlow.

A Mr. Hamje.

Q Is it true that in 1997 Goldman Sachs was retained to advise Premera and its management board of directors about a number of matters including conversion?

A Goldman Sachs was retained to advise the board on capital options, which include a number of options from subordinated debt to sale of assets to conversion to merger with other entities amongst various options that they offered us. Exit from product lines was another item that they suggested amongst the range.

So, yes, they were engaged and they did advise us. And, as a result, as I have testified before, we - the board approved the merger of MSC and Blue Cross of Washington and Alaska into what is now Premera Blue Cross thereby strengthening the balance sheet of Premera Blue Cross.

Q Isn't it true that at that point in time as well that Premera was not in a position to convert because of its financial situation?

A Absolutely. It wasn't even a discussion - a serious discussion at the time because how could we possibly have contemplated a conversion when the company had a record of

1 increasing losses over a number of years. It just - it was
2 not a viable proposition for - for further analysis.

3 Q You indicated in response to questions from counsel
4 concerning withdrawing exiting the PEPB back in 1997. Do
5 you recall that testimony?

6 A Yes, I do.

7 Q Is it not true that at that time the healthcare authority
8 did not renew Premera because Premera had not - had
9 submitted a bid that was too high?

10 A Well, you can frame it whichever way you like. I don't know
11 - recall exactly the circumstances, but submitting a bid
12 that is higher than is accepted is the same as saying we are
13 not going to lower our bid so we can remain in the program.

14 Q Subsequently, Premera submitted bids to the healthcare
15 authority and ultimately did participate in - in the PEPB
16 program; is that correct?

17 A We only participated - as I recall it, Mr. Hamje, we had
18 three - as I recall it, three different offerings to PEPB.
19 We had it through MSC, which was a separate company at that
20 stage, which was a PPO product. We had a HealthPlus
21 offering and we had - which was our HMO, which no longer
22 exists. It has been merged into Premera. And we also had a
23 PPO product offered through Blue Cross of Washington and
24 Alaska. And it is that last contract that we exited.

25 Q But, again, isn't it true that it wasn't - I believe it was

1 effective December 31st of 2003, that no longer did Premera
2 participate in the PEPB program for the state employees?

3 A Well, we exited the Blue Cross of Alaska contract in '97,
4 1998 anyway. I don't have the exact date, but it was about
5 1998. And in 2003 we made a determination not to continue
6 to participate in the remaining products that we still
7 offered to PEPB.

8 MR. HAMJE: Thank you, sir. That's all I have.

9
10 CROSS-EXAMINATION

11
12 BY MR. MADDEN:

13 Q Good morning, Mr. Barlow.

14 A Mr. Madden.

15 Q The corporate strategy of requiring each line of business to
16 at least support itself in some --

17 A Pay for its way over a period of time.

18 Q That's been your business strategy since 1997 as least?

19 A At least.

20 Q And it has taken you some time, apparently, to implement it;
21 is that - is that accurate?

22 A That's not accurate. We have implemented it as best we
23 could judge at the time - at each periodic time that we took
24 a decision as to whether to continue to participate in
25 product lines.

1 We periodically evaluate is a product line going to pay
2 for itself over time. We very reluctantly withdraw from any
3 product line or offering. It is only when we conclude after
4 a period of years that there is just no way out, that it
5 isn't going to be a sustainable product or a line of
6 business for the organization, that we exit.

7 Q Now, to your knowledge, is it correct that Regence and Group
8 Health are still in the Healthy Options and Basic Health
9 Plan lines of business?

10 A They continue in the - in some counties. They are not in
11 all counties that they previously were in.

12 Q Is the strategy of requiring each line of business to
13 eventually support itself, carry its own weight, a strategy
14 that applies to the commercial business as well as the
15 public?

16 A Yes, it is.

17 I'm sorry, the last part of your question, is it applied
18 to --

19 Q The commercial lines of business as well as the public?

20 A You mean the public lines of business?

21 Q Yes, sir.

22 A The same strategy applies.

23 Q You indicated that a for-profit Premera would not have a
24 different business strategy than the not-for-profit company
25 because, after all, in either case the goal is to add

1 membership; is that correct?

2 A I think I what - our goal is to - to grow profitably.

3 Q And, in fact, a company can grow more profitable with
4 younger, healthier and richer members than a company that
5 has older, poorer and sicker members?

6 A I don't agree with that.

7 Q Don't those older, poorer and sicker members present greater
8 underwriting risks?

9 A That absolutely depends. If you look at PacifiCare, it is
10 an organization that is principally focused on the Medicare
11 market, Medicaid Plus Choice, whatever its name is. And
12 they do quite well in that marketplace. So it depends on
13 whether you get premiums that are appropriate to cover the
14 risks involved.

15 Q And PacifiCare charges premiums appropriate to the risks of
16 its insured; correct?

17 A I believe they attempt to.

18 Q You said - you said earlier in response to one of
19 Mr. Kelly's questions that when you negotiate with
20 hospitals, you report there is tension because you are
21 always thinking not only about the needs of the hospital,
22 but about trying to get the best rates for your members; is
23 that correct?

24 A I did say that.

25 Q And - and - and if you were to become a for-profit, you

1 inevitably would be thinking about not only getting the best
2 rate for your members but getting the best deal your for
3 your shareholders? You would be obligated to do that, would
4 you not?

5 A I don't believe those two thoughts are in conflict.

6 Q You would be thinking about both at least?

7 A Well, we think about making a profit today.

8 Q But you have no shareholder - you don't have Wall Street
9 demanding a return on investment today, do you?

10 A We have capital requirements that demand our profitability
11 today.

12 Q But, after all, as you said, you have no investors or
13 investor advisers that are going to be monitoring your
14 performance if you don't return what the market demands?

15 A We do not have those constituencies. We have others.

16 Q You talked a little bit about the situation in Spokane and
17 Premera's agreement to make a mid contract adjustment in the
18 rates with the Deaconess hospital there.

19 Didn't that bolstering of the Deaconess hospital have
20 the effect - the advantageous business effect for Premera of
21 increasing your leverage with the Sisters of Providence
22 hospitals in Eastern Washington with whom you have had some
23 rather public disputes?

24 A I believe it is in the interest of the local community to -
25 to have two hospitals to keep each other in check as to the

1 rates that they charge.

2 Q And in the interest of Premera as well?

3 A It is in the interest of our members. Premera exists today
4 to serve its mission towards its members.

5 Q You - you mentioned some statements attributed to Richard
6 Peterson in the recent issue of the Puget Sound Business
7 Journal.

8 Are you aware that Swedish Health Services is a
9 501(c)(3) charitable organization?

10 MR. KELLY: Objection. No foundation.

11 JUDGE FINKLE: Rephrase.

12 MR. MADDEN: I'm only asking him if he knows.

13 JUDGE FINKLE: Well, that assumes that it is true,
14 so rephrase.

15 Q (BY MR. MADDEN) Do you know whether Swedish is a charity or
16 not?

17 A No, I do not.

18 Q Did you hear Mr. Steel cite the case of Swedish Hospital
19 versus Department of Labor and Industries, the case that he
20 says is the seminal case here in Washington differentiating
21 not-for-profit charitable corporations from noncharitable
22 not-for-profits?

23 A I heard Mr. Steel's testimony, but I did not focus on the
24 exact case citations.

25 Q Finally, Mr. Barlow, how much time did Premera and its

1 consultants spend studying Blue plan conversion attempts in
2 other states?

3 A I don't know how to answer that. We didn't spend a huge
4 amount of time. We were aware of those states and certainly
5 drew from lessons learned in other states to the extent that
6 we didn't have knowledge already.

7 Q And did you - and did you observe in those states where
8 there were strategies pursued by the Blue plan attempting to
9 convert that perhaps failed or backfired?

10 A I'm sure we drew lessons from what other companies have done
11 as we do in every situation, whether it is observing
12 conversions or observing how they bring products to market,
13 whatever.

14 MR. MADDEN: Thank you. I have no further
15 questions.

16

17 CROSS-EXAMINATION

18

19 BY MR. COOPERSMITH:

20 Q Good morning, Mr. Barlow.

21 A Mr. Coopersmith.

22 Q Mr. Barlow, do you believe that payment for care should keep
23 up with the cost of that care?

24 MR. KELLY: I will object. This sounds far beyond
25 the scope of the rebuttal testimony.

1 MR. COOPERSMITH: Your Honor, on the contrary, he
2 testified to the reimbursement practices of his company.

3 JUDGE FINKLE: Overruled.

4 Q (BY MR. COOPERSMITH) You may answer the question.

5 A Could you restate the question?

6 Q Do you believe that payment care should keep up with the
7 cost of providing that care?

8 A In general, yes.

9 Q Do you believe that your company follows that practice?

10 A Yes.

11 Q Do you agree that - with your own executives' testimony that
12 on average Premera's reimbursement to the - statewide has
13 increased 4.7 percent per year?

14 A I don't remember the exact statistic, but I believe that he
15 said something like 20 percent since 1999 through the end of
16 2003. Something like that.

17 Q Would you dispute that that works out to 4.7 percent --

18 A No.

19 Q -- on average?

20 A I'm not disputing. I don't remember the exact percentage.

21 Q And do you recall Dr. Collins' testimony about the increase
22 in operating costs at his clinic?

23 A Yes, I have heard his testimony.

24 Q And do you recall that he testified that it far exceeded the
25 Premera reimbursement rate?

1 A Say that again.

2 Q Do you recall Dr. Collins testifying that the cost of
3 operating the clinic exceeded the costs that Premera paid
4 during those years?

5 MR. KELLY: I will object. I don't think that's a
6 fair statement of the witness - the previous witness's
7 testimony. Object to the form.

8 JUDGE FINKLE: Overruled.

9 A I'm not sure what Dr. Collins defines as the total cost of
10 his practice.

11 Q (BY MR. COOPERSMITH) Mr. Barlow, is it your belief that the
12 operating costs to deliver patient care in this state has
13 increased 4.7 percent or less in the past five years in
14 Washington?

15 A I don't have a number as to exactly how much each clinic's
16 costs have increased. All I can speak to is the
17 marketplace. We observe what is going on in the
18 marketplace, including what our competitors pay in the
19 marketplace. And we believe that --

20 Q And --

21 A -- our marketplace increases have been very competitive.

22 Q And do you believe that when a carrier has 70 percent of the
23 market, that it is, in fact, setting what the market rate is
24 for reimbursement to physicians and hospitals?

25 A I don't agree we have 70 percent market share.

1 Q How much market share do you think Premera has in Eastern
2 Washington, Mr. Barlow?

3 A I can't give you the exact calculation, but my calculation
4 would include all the sources of income to provider
5 practices, which, of course, would include ASO business,
6 which is not included in that 70 percent calculation. And I
7 don't think you can disregard the amount of reimbursement
8 that providers receive from the state and from the federal
9 government --

10 Q And you --

11 A -- in doing that calculation.

12 Q And, Mr. Barlow, you have already testified to your belief
13 that you think that reimbursements that hospitals and
14 physicians receive from the public plans is inadequate; is
15 that correct?

16 A Yes, I do.

17 Q Okay. So let's focus on the - so then, presumably, the more
18 a physician or a hospital sees patients on public plans, the
19 more money they lose; is that correct?

20 MR. KELLY: I will object. This is far beyond the
21 scope of this rebuttal testimony. It is argumentative as
22 well.

23 JUDGE FINKLE: Sustained.

24 MR. COOPERSMITH: Your Honor, in fact, Mr. Barlow
25 testified to --

1 JUDGE FINKLE: Please ask another question.

2 MR. COOPERSMITH: Thank you.

3 Q (BY MR. COOPERSMITH) Mr. Barlow, why don't you tell us what
4 you think the market share is for Premera in Eastern
5 Washington based on your calculations?

6 A I just testified I don't have a calculation of it.

7 Q More than 10 percent?

8 MR. KELLY: I will object. No foundation. Calls
9 for speculation at this point.

10 JUDGE FINKLE: Overruled.

11 A I would say it is over 10 percent. I don't have an estimate
12 beyond that. Excuse me.

13 Q (BY MR. COOPERSMITH) You don't know if it is over 25
14 percent?

15 A I don't believe it is over - I would have to - I'm
16 speculating. I don't believe that it is over 25 percent if
17 you take into account all the sources of payment to
18 providers.

19 Q And, Mr. Barlow, you stated in your testimony this morning
20 that Premera must balance payments to hospitals and
21 physicians with the need to hold down premiums; is that
22 correct?

23 A That's correct.

24 Q All right. And we have - you have just agreed that
25 reimbursement to physicians grows approximately an average

1 of 4.7 percent in the past five years; is that correct?

2 MR. KELLY: Objection. Asked and answered.

3 MR. COOPERSMITH: I believe this is just a --

4 JUDGE FINKLE: Overruled.

5 MR. COOPERSMITH: Thank you.

6 Q (BY MR. COOPERSMITH) Is that correct?

7 A I believe it increased 20 percent between the end of '99 and
8 the end of 2003.

9 Q And are you aware, Mr. Barlow, that during that same time,
10 Premera raised the premiums in the individual market 19
11 percent?

12 A The two are not directly connected.

13 Q Mr. Barlow, I asked you a different question, didn't I? Are
14 you aware that Premera raised the premiums in the individual
15 market during that same period 19 percent?

16 A I'm not aware of the percentage that we increased the
17 individual market --

18 Q Premium?

19 A -- product. Premium.

20 Q Do you dispute the 19 percent figure?

21 MR. KELLY: I will object. This is argumentative.

22 JUDGE FINKLE: Overruled.

23 Is there something we can do about the sound system?

24 A I don't --

25 JUDGE FINKLE: Just one second. I'm sorry.

1 MR. COOPERSMITH: Is this better, Your Honor?

2 JUDGE FINKLE: Maybe you could keep it a bit farther
3 from you. Let's try that.

4 MR. COOPERSMITH: Should we try to proceed?

5 JUDGE FINKLE: Let's try. We are doing okay, but it
6 is not good so perhaps you can work on it. I wonder about
7 cutting off some of the other mics on Premera's and OIC's
8 and maybe the Commissioner's.

9

10 (Brief discussion off the
record.)

11

12 Q (BY MR. COOPERSMITH) Mr. Barlow, are you aware that during
13 that same time period between 1999 and 2003, that Premera
14 raised the premiums and its small group market 15 percent?

15 A I'm not sure what the total percentage increase was over
16 that period of time.

17 Q Do you dispute the figure of 15 percent of premium increase
18 since 1999 in the small group market?

19 A I don't dispute it. I don't know what it is.

20 Q And you had discussed in your testimony today the need for
21 new capital for Premera; is that correct?

22 A I believe that's correct.

23 Q And among the needs that were shown on the screen, as well
24 as testified to previously, was the need to fund new
25 initiatives; is that correct? New initiatives to benefit

1 subscribers and providers; is that correct?

2 A I believe what I have testified to is that we need to
3 increase our risk-based capital so that we can fund various
4 things, including strengthening our reserves, being able to
5 increase our membership and thereby to be able to continue
6 to ensure technology and other infrastructure that are
7 desirable to our present and future members.

8 Q And you also testified to needing new capital for new
9 products and services; is that correct?

10 A In the same context, that is correct.

11 Q All right. And were you at the hearing when Dr. Gollhofer
12 testified to Premera's new initiative on chronic disease
13 management?

14 A Yes, I was.

15 Q And he testified that that was an example of what Premera
16 wants to undertake; is that correct?

17 A Of many examples.

18 Q And - well, that was a primary example that he used in his
19 testimony; is that correct?

20 MR. KELLY: I will object. It is argumentative as
21 to what is primary.

22 JUDGE FINKLE: Overruled.

23 Q (BY MR. COOPERSMITH) You were here. Do you recall him
24 testifying to that effect, Mr. Barlow?

25 A He testified as an example of increasing the number of

1 disease management programs, is that your question?

2 Q And to the importance of the disease management program as
3 an example of Premera's new initiatives; is that correct?

4 A I don't recall him specifically saying how important this
5 specific initiative is relative to all the others.

6 Q Let me just ask you: Do you recall the chronic disease
7 management program as an important initiative to Premera?

8 A One of many.

9 Q Do you recall Mr. Ancell saying that primary care providers
10 have the least ability to negotiate payment rates with
11 Premera?

12 A I don't specifically recall that, but I would say as a
13 generalization that seems to be true.

14 Q And how is it, then, Mr. Barlow, that - you had testified
15 that disease management programs are the primary providers -
16 are the providers negotiating with Premera?

17 MR. KELLY: I will object. This is just
18 argumentative.

19 JUDGE FINKLE: Sustained.

20 Q (BY MR. COOPERSMITH) Do you recall when Dr. Gollhofer was
21 testifying he was asked to name any healthcare initiative
22 that Premera could only do as a for-profit company? Do you
23 recall that question?

24 A Not specifically.

25 Q Do you recall that Dr. Gollhofer was not able to identify a

1 single healthcare initiative that Premera could do only as a
2 for-profit?

3 MR. KELLY: This is argumentative. The transcript
4 says what it says.

5 JUDGE FINKLE: Sustained.

6 Q (BY MR. COOPERSMITH) Are you able to identify any
7 healthcare initiative that Premera can't do now that it
8 could do as a for-profit company?

9 A I testified earlier to initiatives that we would like to
10 undertake that would be enhanced with - with additional
11 risk-based capital, which would enhance our ability to
12 increase our membership and, therefore, would enhance our
13 ability to continue to invest in programs.

14 One of them was to increase the enablement of our - I'm
15 sorry - our connectivity with physicians and other
16 providers.

17 Q Is that something you cannot do as a nonprofit company in
18 your belief, Mr. Barlow?

19 A We are certainly constrained. We haven't done it today.

20 Q And have you not just spent 125 million dollars on the
21 Dimensions platform which is, by Premera's own testimony,
22 state of the art in the industry?

23 MR. KELLY: Objection. Argumentative.

24 JUDGE FINKLE: Sustained.

25 A I believe I --

1 JUDGE FINKLE: Excuse me. Sustained.

2 Q (BY MR. COOPERSMITH) Do you believe that the Dimensions
3 program is the state of the art program in the healthcare
4 insurance?

5 A I believe it is the state of the art with the need for many
6 enhancements.

7 Q And did Premera, in fact, spend 125 million dollars on that?

8 A Approximately.

9 MR. COOPERSMITH: No further questions at this time.

10 JUDGE FINKLE: Other Intervenors?

11 MS. McCULLOUGH: No, thank you.

12 MR. KELLY: I just have one quick area. Is there
13 someone else that has questions?

14 MR. COOPERSMITH: No. No. It is the microphone.

15 MR. KELLY: Okay.

16

17 REDIRECT EXAMINATION

18

19 BY MR. KELLY:

20 Q Just a bit about rates. What is the primary component of a
21 premium rate?

22 A Approximately 84 percent of Premera's costs are - in
23 premiums are healthcare costs.

24 Q And what causes increases in the individual and small group
25 market rates that you have seen over the past seven years?

1 A There is a combination of changes in unit costs from our
2 providers including the unit cost increases that
3 Mr. Coopersmith referred to for physicians, for hospitals,
4 for pharmaceuticals, multiplied by the changes in
5 utilization by our - the population, that is first aging,
6 and secondly, demanding the latest and greatest technology.

7 Q Okay.

8 MR. KELLY: Excuse me.

9 That's all I have. Thank you.

10 MR. HAMJE: We have no further questions. Thank
11 you, Mr. Barlow.

12 JUDGE FINKLE: Any follow-up by Intervenors?

13
14 RECROSS-EXAMINATION

15
16 BY MR. COOPERSMITH:

17 Q So, Mr. Barlow, are you testifying that payment to
18 physicians in hospitals for medical services is only a part
19 of what contributes to premium rates?

20 A Sorry. Your question is a little bit obscured by the sound
21 system, but is your question is the increasing payments to
22 physicians only a part of the increase in total healthcare
23 costs?

24 Q In - only a part in how Premera decides - or whether Premera
25 decides to raise premiums and by how much?

1 A They are there are two questions in there. Which one do you
2 want me to answer?

3 Q Both.

4 A Both?

5 MR. KELLY: Well, I object to the compound
6 questions. Sorry. I was a little slow on the uptake there.

7 Q (BY MR. COOPERSMITH) Mr. Barlow, do - are payments to
8 physicians and hospitals for healthcare services only a part
9 of what the leads to premium increases? Yes or no?

10 A Well, increases in unit costs are part of the healthcare -
11 total healthcare increases, yes.

12 MR. COOPERSMITH: Nothing further.

13 MR. KELLY: Nothing more here.

14

15 EXAMINATION

16

17 BY COMMISSIONER KREIDLER:

18 Q Mr. Barlow, let me touch on a couple of issues, if I might.
19 One of them certainly has been to the restrictions of the
20 Blue Cross/Blue Shield Association. It is hard not to
21 sometimes feel that you are caught between playing chicken
22 or being blackmailed, you know, it is trying to find that
23 appropriate balance. And I can appreciate the dilemma that
24 Premera has with its two percent share of the voting of the
25 association and being able to strike an agreement.

1 I think the difficulty, however, is that it is difficult
2 without having something written down to know what is going
3 to be approved. And I think going beyond that, perhaps -
4 and maybe you can tell me I'm wrong on this, but I don't
5 know that we ever have seen what are - what are the
6 agreements that have been struck with other insurers that
7 they have been written down that the Blue Cross/Blue Shield
8 Association has agreed to so that we have something harder
9 as a benchmark to measure ours.

10 Am I correct in that assumption, that we don't have a
11 clear delineation as to where the Association has been and
12 approved in the past?

13 A Commissioner, I have not read them specifically, but I
14 believe that the restrictions would be fairly well outlined
15 in prospectuses that - of the share offerings and certainly
16 they would be outlined in some documents that the
17 foundations have that are pretty well-known to the state's
18 consultants, who are very experienced in this matter. And I
19 believe that we have a pretty good understanding through -
20 through the research that our staff has done as to what
21 those restrictions are.

22 I understand that the restrictions that were - the - I
23 should say - not the restrictions, but the exceptions that
24 were granted - because remember the restriction is absolute.
25 You may not have more than a ten percent and five percent

1 accepting with agreed to exceptions. The exceptions that
2 were agreed to in the WellChoice deal are well understood as
3 well as by our staff and by the Commissioner's - or, sorry -
4 the OIC's consultants.

5 Q But it is still going to be somewhat of a matter of
6 interpretation because it isn't something that is defined
7 as, so to speak, hard and fast rules of the Association; is
8 that fair to say? That you are still going to have to take
9 a look at agreements that were struck, it is not a matter of
10 going to the Association, here line by line are the
11 conditions for any conversion that takes place within our
12 association as to what you have to have as restrictions?

13 A Right. I think it is fair to say that the hard and fast
14 rule that is written down - or that is memorialized in the
15 regulation that regulates us from - under our license with
16 the Blue Cross/Blue Shield Association are - are very
17 well-documented.

18 Exceptions, by their nature, are going to deal with
19 exceptions and therefore, we do have to examine what
20 exceptions have been granted. And we have done that and we
21 have tried to line up the exceptions that were granted in -
22 for example, in the WellChoice case.

23 When we went back to argue the case with the PPFSC, we
24 said, what about this five percent stock holding and they
25 said - they said - well, actually, I don't believe we ever

1 got in writing exactly - we presented what I think we
2 understood what their arguments were, which is in the brief
3 that - in my prefiled testimony.

4 So we articulated reasons for granting exceptions. We
5 articulated what we understood their reasons to be for not
6 granting - this is the staff. Remember, we dealt with the
7 staff first and then we went to the PPFSC who supported
8 the staff - actually, the staff supported the PPFSC -
9 explaining what the staff's position was, why we believe
10 that the staff's position was not valid and an exception
11 should be made to what they believe was the furthest that
12 the PPFSC had gone in the past.

13 And the PPFSC agreed with us on one of the three. On
14 the - another one was a saying that on the sell-down
15 schedule, they are saying that - they don't disagree that it
16 can be a separate sell-down schedule, they just say they
17 must be pro rata to what would be a single sell-down
18 schedule.

19 So they don't argue that you can have two, but - they
20 would be agreeable to that, but it would have to be pro rata
21 to the share distribution in - and so it was only in the
22 third instance that they totally rejected our plea, which
23 was having two separate five percent minus one share
24 independent voting stocks, that they believe only one is
25 appropriate in the inception of granting process.

1 Q You heard the testimony, I imagine, that you were probably
2 active with the Association, or at least Premera was, in the
3 consideration of what took place in Maryland with the Blues
4 plan.

5 A Yes. Not to say unequivocally. I understand what happened
6 in Maryland. I was not at all directly part of that with -
7 on the board committee. I was not part of that. The Plan
8 Performance Financial Standards Committee, once again, was
9 involved in overseeing the Association's position relative
10 to the Maryland situation.

11 Q And I understood that. You just qualified it?

12 A Right.

13 Q But certainly understanding that it would appear that there
14 was some rather what - you would call them some kind of a
15 tolerance policy exhibited towards Maryland that appeared to
16 go beyond the restrictions that we are talking about right
17 now for Premera's conversion?

18 A Could I comment on that?

19 Q Please do.

20 A I absolutely agree that they made exceptions in Maryland to
21 the licensing agreement, which it was separate and apart
22 from any stock holding. Obviously there was no conversion.

23 Q Yeah.

24 A Just bear in mind, it is a very different position. You had
25 three major states covered, including federal employees

1 without access in Washington D.C. to a Blues network. Now,
2 that is a very important part of the Blues as a whole.
3 Liken that with Premera Blue Cross out here in Washington
4 with a competing Blue in the marketplace. There is no such
5 situation in - back east, where we are two percent of the
6 total members and our bargaining, from my position - I'm not
7 suggesting that the Commissioner would bargain - I'm saying
8 from our position we just don't have the kind of bargaining
9 clout that that situation warranted.

10 Q And I can appreciate that point. We are not on the same
11 footing necessarily.

12 One of the items that - in fact, it was part of the
13 slide that you started with, which were kind of the three
14 different reasons as to why you were looking to be able to
15 raise capital. One of them isn't explicit, maybe implicit,
16 but not explicit. It was to remain independent.

17 And I'm kind of concerned about the potential impact
18 even with - with the restrictions that we talked about here
19 from the Blues Association, what stops an Anthem or a
20 WellPoint from coming in? Because they are not restricted
21 to the five and the ten percent, they could come in and
22 essentially buy a much larger share and essentially take
23 ownership of Premera that way.

24 A Right.

25 Q How do you respond to that in the concept here that we are

1 going to raise capital by going public, but in effect by
2 doing so you may lose your independence?

3 A As I'm aware - I'm not a lawyer, so I can only give you my
4 understanding as a business leader of the restrictions. As
5 I understand it, if any company under the securities clause
6 or stock exchange rules, I'm not sure which, but rules that
7 govern a public company, if any entity acquires more than
8 five percent of a company, they have to inform the board of
9 that company that, in fact, they have bought five percent.

10 And the board can then make a determination to prevent
11 that company from acquiring it even if they continue to buy
12 the stock, as I understand it. The main effect of this is
13 for a period of three years. So there are not many public
14 company that are patient in buying shares in another
15 company, which is going to cost them a pretty penny in the
16 public marketplace to do that, and then sit on it for three
17 years while the board has prevented them from actually
18 taking over, therefore being able to extract the quote,
19 unquote, synergies that they need to extract to justify the
20 amount of the shares that they bought.

21 So that's a very real barrier that we have taken
22 advantage of under Washington law that would be available to
23 us - that is available to us, that we have taken advantage
24 of.

25 Second, and perhaps not as compelling, but I will tell

1 you that I have heard directly from Leonard Schaeffer, who
2 was the head of WellPoint - and he said this in public
3 forums - that his board had determined not to make any
4 hostile takeovers. And he will not - he has said it in so
5 many places that you eventually have to believe him
6 otherwise he would lose all credibility.

7 Now, I know in the combined Anthem WellPoint group, he
8 would only be the chair of the group and that is only for
9 two years, but I have seen no signs from Larry Glasscock,
10 who is the CEO of Anthem and the new WellPoint when they had
11 merged, to tell me that he would make any hostile takeover
12 attempt, but that's - you know, that's comforting. That's
13 relying on the personality.

14 But the most important thing is we take as much
15 proportion as we can under the Washington law to prevent a
16 hostile takeover.

17 Q Hostile or not hostile, would it appear that that is
18 something that, as a public company, it would be something
19 that potentially could compromise the independence of
20 Premera; is that fair to say?

21 A Well, I believe under Washington law, a board - if an offer
22 is made, hostile or friendly, the board is obliged to
23 consider it, but not to accept it based merely on the price
24 that is being offered.

25 It can, as I understand it, take into account other

1 factors, such as whether it is important to have a presence
2 in the local marketplace, the role as employer in the
3 marketplace and so on. So, once again, our filing included
4 that - that ability under Washington law, so the board can
5 consider something beyond price.

6 Q At some point, presumably, the board would be derelict if it
7 did not respond to an offer that, so to speak, is too good
8 to on its face say no to without being subject to
9 stockholder suits; isn't that fair to say?

10 A Well, I think anybody can sue for anything. That's the
11 American way, but it doesn't mean that they can be
12 successful, as I understand it.

13 I don't think they would be derelict in refusing to
14 accept an offer if under Washington law, as I understand it
15 - once again, I'm not a lawyer, this is just as I understand
16 it - they would not be derelict if in - if in fulfilling
17 their duties they did consider other factors and those
18 factors weighed more heavily than pure purchase price.

19 Having said all that, of course, a board is going to
20 feel pressure if a company is not performing well to say
21 well, we really - this gets back to what I said earlier in
22 my testimony today, is that if a company is not being valued
23 by the local market, somebody else can buy you and make a
24 much better show of it with customers who reward that
25 buyout, well then, the board is going to have to consider

1 that.

2 And so there is always a risk. So that's why I say this
3 management entrenchment, getting back to that earlier, is
4 just - you have to be performing well in the public
5 marketplace to avoid putting your board under that kind of
6 pressure.

7 Q I probably started off really going with the idea that the
8 Blues mark is a valuable asset of the Premera corporation,
9 so it is focusing more on a, let's say, a for-profit Blues
10 plan that would essential - be essentially in the market?

11 A Right.

12 Q But I think it is fair to say, touching on the market here,
13 is whether it is a nonBlues public company that made an
14 offer, I think - and I think you adequately answered that
15 question that I had in my mind.

16 A I should - a nonBlue - a nonBlue could buy Premera. It is
17 just that to do that they are going to sacrifice a lot in
18 lost membership because obviously the members that we have
19 in the corporation that we provide insurance to value the
20 networks that we provide collectively as a Blue
21 organization.

22 The Blue - the Blue network and the Blue card program
23 that we have is, in my view, the most powerful asset of
24 being a Blue. And they would lose that and probably lose a
25 lot of membership. And it would be a very expensive

1 acquisition for them as a result.

2 Q You say it is very valuable, but it wasn't valuable enough
3 in the Washington Mutual case apparently though, was it?

4 A You know, a lot of considerations come into how our
5 consultants decide whether they are going to recommend an
6 organization and, you know, some of it is who do they know,
7 and therefore - not in the good old boys club, by any means.
8 Is it is who do they know that they can rely on because they
9 have had experience with them in the past.

10 So when you are big in the national accounts business,
11 which we are not, then you have to go the extra mile to make
12 them comfortable. And in this case we didn't get them
13 comfortable despite the discounts that were favorable. I
14 think they would have saved money, but be that as it may,
15 they chose to go a different route.

16 Q And you touched on it briefly, on the discussion of a merger
17 acquisition that would take place, and that was the
18 entrenchment of the board. Is it fair to say that if the
19 stock is restricted within - the voting rights of the stock
20 are restricted in the foundations, that the board and
21 management would be in a - in a - in a secure position?
22 That is not to say that you are secure necessarily as a
23 not-for-profit, but from the standpoint of voting in a
24 public company, you would at least have those protections
25 there?

1 A Right.

2 Q Isn't it argued that potentially that - that from that
3 standpoint that management and the board would potentially,
4 based on performance, be able to do personally better
5 financially as a public company than they would if they did
6 well as a not-for-profit?

7 A Okay. Can I address two parts of --

8 Q Sure.

9 A -- your --

10 Q Preface?

11 A -- Preface?

12 There - the first part is I have to reiterate,
13 management has certainly no guarantees in terms of
14 employment. It is very clear to me that I serve at pleasure
15 of the board and, I think, to people who work for me
16 likewise. So, you know, management doesn't feel entrenched
17 one way or the other.

18 The board has protection to protect - for good reason to
19 protect astuteship of the organization. But you must take
20 into account, as far as the board is concerned, that we have
21 a - a bylaw within the organization that it is a nine-year -
22 three three-year service period, so nine years.

23 And I can't give you a number, but off the top of my
24 head, it is around about - I would guess the average of the
25 board has got four-and-a-half years. So they are about

1 halfway on average in their tenure, as Jewell, who testified
2 earlier, is towards the end of her tenure. In fact, we are
3 making a special exception to extend hers - but it is an
4 exception, we haven't done that before - for another two
5 years. The board has agreed to do that and wants to do that
6 because of the special role that she has within the
7 organization and hopefully this transition into a new role.
8 But she will go off the board in two years.

9 So the entrenchment of the board, just to get back to
10 that, is not an indefinite entrenchment under the rule by
11 which they are operating and which they have established for
12 themselves.

13 Getting back to is there potential reward? Well, yes,
14 there is a potential reward to the board, not astronomical,
15 but there is a reward to the board that is commensurate with
16 the marketplace for public companies and conservatively, as
17 has been testified to by the state consultants to that
18 issue. It is a very conservative stock option program.

19 But, of course, I cannot fail to point out that a stock
20 option is worthless until the value of the company - company
21 shares have gone above the starting price at the time that
22 they were granted. And it is justifiable to reward, I
23 think, for improving the value of the company and the
24 stockholders and not the least of which, of course, is the
25 stock - the two foundations that we have been talking so

1 much about.

2 And, secondly, there is additional exposure. I mean, I
3 said anybody can sue for anything and it is not much fun
4 being sued as a director because whether it is - it is
5 somehow settled or dismissed or, you know, hopefully not
6 ever judged against in court, you face exposure and it - I
7 don't know how you attract board members in a competitive
8 marketplace for board members unless you offer some
9 commensurate compensation with the risks that they face.
10 And there will be new risks.

11 COMMISSIONER KREIDLER: Thank you very much,
12 Mr. Barlow. I have no further questions.

13 MR. KELLY: I have just one follow-up.
14

15 REDIRECT EXAMINATION
16

17 BY MR. KELLY:

18 Q The Commissioner asked a question about whether there have
19 been any comparisons of the various Blues conversions.

20 And if I could ask everyone to turn their attention to
21 Exhibit P-81 and I'm going to bring a copy of it up to you,
22 Mr. Barlow. I'm not going to ask you to go through this
23 multipage exhibit, but as it unfolds, my question to you is
24 is this a matrix comparison of Premera in certain
25 regulations and requirements of its conversion in comparison

1 with WellChoice, RightChoice, Cobalt and WellPoint?

2 A Yes, it is. And all of the listed organizations are - were
3 Blue plans.

4 Q Okay.

5 MR. KELLY: That's the only question I have.

6 MR. HAMJE: No questions.

7

8 EXAMINATION

9

10 BY COMMISSIONER KREIDLER:

11 Q Mr. Barlow, I believe that, as you pointed out, this list
12 would not include Maryland because there was not - that was
13 not a successful conversion; is that correct?

14 A That is correct. And I don't know what restrictions would
15 have been - I don't know anything about that finding. I do
16 not know.

17 Q But there were encumbrances, or whatever it might be called,
18 so to speak on the Blues approval essentially of allowing
19 the Blues plan in Maryland to continue to operate under
20 rules that were exceptions effectively to what would be the
21 standard for other for-profit Blues; is that fair to say?

22 A If your question is would there have been restrictions on
23 the Maryland, Delaware and DC plans which make up CareFirst?
24 Had they successfully converted, I'm sure there would have
25 been restrictions. I don't know what they would have been.

1 As a nonprofit, the requirements within the Blue Association
2 are still that no Blue should be controlled by - other than
3 an independent board. And so the negotiation that resulted
4 in five - I think it was five new board members being
5 appointed to replace the previous board - it was done in the
6 context - somehow the mechanics of it worked out that the
7 state never fully had control over that Blue plan despite
8 having - or the combined plan of the three states, despite
9 having five appointed members.

10 The initial plan under the legislation in Maryland
11 clearly put them in violation of being controlled by a
12 single outside entity, such as the Maryland state
13 legislature or its appointees, and that is why the license
14 was pulled.

15 Q If I understand correctly, though, that if, in fact, the -
16 the same restrictions on the existing not-for-profit Blues
17 plan in Maryland had carried over to a conversion in a
18 comparable fashion, it would be inconsistent with what is,
19 so to speak, on the table right now for Premera and the
20 Blues Association?

21 A If a part of the approval for the conversion of CareFirst
22 was a requirement that they had five directors appointed by
23 the state, that would have been an exception that had not
24 previously been granted in any other conversion that I'm
25 aware of.

1 COMMISSIONER KREIDLER: Thank you very much.

2 MR. KELLY: No further questions.

3 MR. COOPERSMITH: Your Honor, I have one brief
4 question.

5

6 RECROSS-EXAMINATION

7

8 BY MR. COOPERSMITH:

9 Q Mr. Barlow, will the Premera board commit under oath to
10 oppose any attempt to acquisition of the company, hostile or
11 friendly?

12 MR. KELLY: Objection. Argumentative.

13 JUDGE FINKLE: Sustained.

14 Q (By MR. COOPERSMITH) Will the Premera board commit under
15 oath to oppose any attempted acquisition of the company?

16 MR. KELLY: I will object. Argumentative. The
17 pattern of questions here I object to in general.

18 JUDGE FINKLE: Overruled.

19 A Could you repeat your question?

20 Q (BY MR. COOPERSMITH) Will the Premera board commit under
21 oath to oppose any attempted acquisition --

22 MR. KELLY: I will object to argumentative and no
23 foundation for this witness. He is not a member of the
24 board.

25 THE WITNESS: I am a member of the board.

1 MR. KELLY: Oh, I'm sorry.

2 JUDGE FINKLE: You had me going there.

3 Overruled.

4 A No. As I testified to - directly to the Commissioner, the
5 board has not decided to pursue independence as an end in
6 and of itself but as the way we currently best serve our
7 membership. The board would not commit itself to never - to
8 never agreeing to an acquisition if at some point in the
9 future it concluded independently of management that it was
10 in the best interests of the members that we serve to do so.

11 MR. COOPERSMITH: No further questions.

12 JUDGE FINKLE: Follow-up?

13 MR. HAMJE: No questions.

14 MR. KELLY: No, sir.

15 JUDGE FINKLE: You may step down.

16 Does that conclude the rebuttal evidence from Premera?

17 MR. KELLY: That's our rebuttal evidence.

18 JUDGE FINKLE: Any rebuttal or surrebuttal from
19 others?

20 MR. COOPERSMITH: Nothing further from the
21 Intervenors, Your Honor.

22 JUDGE FINKLE: And that's --

23 MR. COOPERSMITH: Including Alaska.

24 MR. HAMJE: Nothing from the OIC staff.

25 JUDGE FINKLE: Can we consider, subject to the

1 Friday technical evidentiary deadline, that the evidence is
2 now closed?

3 MR. HAMJE: One second.

4 We do have some of the deposition cross-designations
5 that I think could be submitted at this time, if that would
6 be appropriate.

7 JUDGE FINKLE: That would be fine.

8 Any other additions to the evidence?

9 MR. COOPERSMITH: Nothing from the Intervenors, Your
10 Honor.

11 MR. KELLY: Nothing from Premera, other than the
12 Friday deadline.

13 JUDGE FINKLE: And just to touch bases with you on
14 your closing estimates, are those still alive? You have
15 given me general idea of how long you would expect to take.

16 MR. KELLY: I think Premera will be approximately 45
17 minutes.

18 MR. HAMJE: I believe that the OIC staff's will be
19 about 30 minutes.

20 MR. COOPERSMITH: And, Your Honor, the Intervenors
21 believe we will consume less than an hour total amongst us.

22 JUDGE FINKLE: Okay. I think we can take a break
23 now. We'll see you at 2:00.

24 MR. HAMJE: One item, Your Honor. I want to go
25 ahead and for the record and ask that Exhibit S-125, S-126,

1 S-127 and S-128 be admitted into the record. These are our
2 cross-designations.

3 JUDGE FINKLE: Any objection.

4 MR. COOPERSMITH: None, Your Honor.

5 MR. KELLY: No objection.

6 JUDGE FINKLE: Admitted.

7 We will see you at 2:00.

8 MR. HAMJE: Thank you.

9
10 (Lunch recess.)

11
12 JUDGE FINKLE: Ready to proceed?

13
CLOSING ARGUMENT

14 BY MR. MILO

15
16 MR. MILO: Good afternoon, Commissioner Kreidler,
17 Judge Finkle. I want to begin by thanking you, Commissioner
18 and your staff and the special master, for doing all the
19 work that was needed to bring this hearing together. We
20 also appreciate your careful attention to the many
21 prehearing motions, your reading of the voluminous reports,
22 prefiled testimony and exhibits and your thoughtful
23 evaluation of this conversion request, which is so important
24 to Premera, its subscribers and the insurance-buying public.

25 We came here more than two weeks ago to present

1 Premera's Form A filing to you to allow Premera to
2 reorganize as a public company so that it can access the
3 capital markets.

4 In those two-plus weeks an enormous of material has been
5 presented. Several dozen witnesses for Premera, the OIC
6 staff and Intervenors have all weighed in with their views
7 on conversion. And that's on top of the volumes of material
8 that was already before you in the form of expert reports
9 and prefiled testimony.

10 You have the unenviable task, but the critical task, of
11 sorting through all this information to make a decision on
12 the Premera Form A, a decision which is required to be made
13 applying the standards of the Holding Company Acts.

14 As I was agonizing about what I wanted to say to you as
15 part of this closing, a couple of things became clear to me.
16 It would be easy to get so caught up in all the details and
17 miss the big picture. So I won't try to summarize all of
18 the testimony, I'm sure you are relieved, or to rebut each
19 and every argument that has been made against conversion or
20 to try to articulate all the ins and outs of the law that
21 apply to this conversion. That I will leave for Premera's
22 posthearing brief and the points we made in the brief that
23 we filed prior to the start of the hearing.

24 I would rather, at this time, focus on five key points I
25 think are important to keep in mind as you begin to consider

1 all that - all the information that is before you.

2 First, why has Premera proposed this reorganization?

3 Second, what is required by the Holding Company Acts and how
4 did the Premera conversion proposal stack up? Third, what
5 is all this discussion about charitable trust principals and
6 fair market value and how does that relate to the Holding
7 Company Acts? Fourth, what is the real scope of the
8 difference between Premera and the OIC consultants in this
9 case, especially in light of the stark disparity between
10 some of the positive testimony you heard from many of the
11 state consultants in contrast to the recommendation you
12 heard yesterday from Deputy Commissioner Odiorne? And,
13 finally, given Deputy Commissioner Odiorne's
14 recommendations, how does Premera propose to proceed from
15 this point?

16 So let's start with why Premera has proposed this
17 conversion. As Sally Jewell, who is here with us today, and
18 other directors have testified, the board of directors, not
19 management, made the decision to convert. The board made
20 that decision after a careful, exhaustive year-long due
21 diligence. And the board made that decision in exercising
22 its fiduciary duty to Premera and to benefit Premera's
23 current and future subscribers.

24 And you have heard this repeatedly, but it can be lost
25 in all the ruckus to the contrary. The board seeks to meet

1 those objectives in three ways: First, by strengthening
2 Premera's reserves. Reserves on which our members rely so
3 we can meet our obligations and protect against economic
4 uncertainties. As Donna Novak and others have testified,
5 Premera's risk-based capital is among the lowest in the Blue
6 Cross/Blue Shield system.

7 Next, by supporting membership growth, that is bringing
8 Premera products to new members. As Mr. Marquardt has
9 testified, as well as other experts, that helps spread the
10 cost of coverage across a broader base and helps mitigate
11 upward pressures on premiums.

12 Third, providing a source of funds for improvements to
13 infrastructure, like technology, as Mr. Smit and others have
14 testified, funding for the development of products and
15 services as described by Mr. Barlow, Ms. Donigan and
16 Dr. Chauhan all to better serve Premera's members.

17 So it is simple. In and of itself, these are laudable
18 goals, objectives that are laudable by anyone's standards.
19 So where is the controversy? Opponents to the conversion
20 have expressed concerns, concerns that by converting in
21 spite of these positive objectives, subscribers and the
22 insurance-buying public may suffer by virtue of Premera's
23 proposed corporate form.

24 So let's look at how the Holding Company Acts apply to
25 Premera's proposal in light of these concerns raised by OIC

1 staff and the Intervenors. What is required by the Holding
2 Company Acts? This poses two questions. First, what are
3 the substantive criteria under the acts? Second, what is
4 the burden that must be made to deny the Premera
5 application?

6 Now, Mr. Mitchell reviewed in detail the standards which
7 apply to the Holding Company Acts, with Mr. Cantilo's
8 assistance, at the Elmo the other day. And as Mr. Cantilo
9 reports and his testimony in the hearing reflects, there is
10 no issue in dispute between him and Premera as to many of
11 the provisions of the Acts.

12 First, Mr. Cantilo has confirmed that Premera meets the
13 requirements to register as a health carrier. Second, as to
14 antitrust considerations, Mr. Cantilo confirmed
15 Dr. Leffler's view that the conversion will not have an
16 anticompetitive effect.

17 Putting aside for the moment any debate on the
18 applicability of other sections of the Acts, Mr. Cantilo
19 also confirmed that as to Premera's financial condition as
20 stated in the Cantilo & Bennett report, the conversion will
21 not adversely impact Premera's financial condition.

22 And, finally, as to the competence, experience and
23 integrity of Premera's management, Mr. Cantilo,
24 Mr. Koplovitz and other state consultants have testified
25 that they have no reservations in this regard.

1 So are there any problems raised by the state
2 consultants under the Holding Company Act standards? There
3 is only one open issue raised by the consultants echoed by
4 the Intervenor with respect to these standards. And that
5 is could the conversion result in increased premium rates
6 for individuals and small groups in Eastern Washington and
7 if so, would the transaction be unfair or unreasonable to
8 Premera subscribers and not in the public interest or likely
9 to be hazardous or prejudicial to the insurance-buying
10 public?

11 Let's look at that in more detail. First, let's look at
12 the burdens that must be met to deny the conversion proposal
13 on this basis. The record in this case and the Holding
14 Company Acts are clear in this record. As you know,
15 Commissioner, the statute provides that an application for
16 conversion shall be approved unless the Commissioner finds
17 that New Premera cannot satisfy the requirements of the
18 Acts. So did either OIC staff or the Intervenor's witnesses
19 meet that level of proof? Absolutely not.

20 The OIC consultants base their concern about possible
21 increases in premiums, possible increases based on an
22 economic model and on speculation that Premera might try to
23 do an end around Washington's community rating laws. That
24 is those same community rating laws that Ms. Halvorson,
25 Premera's chief actuary, and Ms. Lee, the OIC's chief

1 actuary, interpret in the very same way.

2 Let's look a bit closer at the rationale of the OIC
3 consultants on this point. The PwC concern about premiums
4 is based on a PwC economic model, but the testimony at
5 hearing showed that this model does not predict that Premera
6 could or would increase rates. It simply says if you want
7 to reach a certain target margin, how high must rates go?
8 And it also assumes that you can raise rates with impunity.

9 Mr. Gold testified that he did not include regulatory
10 constraints in the model. And the reason he gave is that
11 would be a pretty complicated model. And did Mr. Gold have
12 impediments to including the regulatory constraints in that
13 model? He testified that there was no lack of resources to
14 do it.

15 And what was the assessment of Mr. Gold's predecessor in
16 his farewell e-mail? Mr. Gold's predecessor criticized
17 PwC's failure to include regulatory constraints in the model
18 as other - as well as other defects in the methodology. His
19 observation, quote, "Garbage in, garbage out."

20 It is patently absurd to assume away a key factor such
21 as applicable regulatory constraints. That would be amusing
22 but for the fact that it is so irresponsible. The PwC model
23 and the accompanying opinion of his experts not only fail to
24 meet the burden of proof, they simply lack credibility.

25 And what of the Intervenor's assertions regarding the

1 impact of conversion on premium rates, provider
2 reimbursements and service levels? Speculation based on
3 selected anecdotes from other conversions in other states
4 with other laws and other economic circumstances do not
5 carry the burden of proof either, nor does an ideological
6 bias that publicly traded companies inherently serve
7 shareholders at the expense of customers.

8 And it is interesting to note, Commissioner, in response
9 to your question to Mr. Benbow of Consumer Union regarding
10 the California experience, you asked would he, if he could
11 turn back the clock, undo the WellPoint conversion because
12 the perceived detriment outweighed the benefits? And his
13 answer - he said he was not in a position to say that.

14 None of the speculation about premiums, provider
15 reimbursement or service levels meet the Intervenors burden
16 of proof. By contrast, the testimony of both Premera and
17 OIC economic experts prove the contrary. Dr. McCarthy
18 testified Premera does not have market power in Eastern
19 Washington.

20 Now, Dr. McCarthy is Premera's expert, but let's listen
21 to what Dr. Leffler, an OIC expert who is a professor of
22 economics at the University of Washington said. He
23 testified while applying a different definition of market,
24 much the same as Dr. McCarthy - Dr. Leffler concluded as to
25 provider reimbursements, Premera does not have the

1 opportunity to squeeze provider reimbursements in Eastern
2 Washington. It has exhausted its market power to keep down
3 provider reimbursements.

4 How about premiums? Premera can't raise premiums in
5 Eastern Washington even if it wanted to because of
6 regulatory requirements to the community rating and achieved
7 revenue neutrality consistent with Ms. Lee's testimony.

8 So to summarize the application of the Holding Company
9 Acts, the Form A meets the standards which apply and neither
10 the OIC staff nor the Intervenors have submitted any
11 credible evidence to the contrary, let alone to carry the
12 burden of proof to reject this application.

13 As to the Form D documents, which are part of the
14 application, Mr. Cantilo testified that the application
15 meets the Form D requirements with, in his opinion, a single
16 exception. His concern is that the Premera guarantee to the
17 Washington operating subsidiary should parallel the
18 guarantee that is being given to the Alaska subsidiary.

19 Now, Mr. Cantilo noted Mr. Marquardt's prefiled
20 testimony and interprets it correctly for the proposition
21 that Premera could and will accept the change proposed by
22 Mr. Cantilo. While Premera does not concur that is a
23 requirement - a Form D requirement, Mr. Marquardt's
24 testimony was submitted, indeed, to document Premera's
25 willingness to conform the Washington guarantee to the form

1 of the Alaska guarantee as requested by Mr. Cantilo.

2 I want to comment next on the question of charitable
3 trust and fair market value. Having talked about the
4 Holding Company Act, let's look for a minute at all the
5 discussion about charitable trust principles and assertions
6 about fair market value.

7 What is that all about and what is its importance?
8 Major portions of the Cantilo & Bennett report hinge on the
9 assessment, as stated in the report, that Premera is some
10 form of public benefit corporation or a charity obligated to
11 transfer its fair value to the foundations. The Cantilo &
12 Bennett report is silent on how and why it sets out that
13 position, but many of its conclusions are based on it.

14 Mr. Mitchell asked Mr. Cantilo about this in his
15 depositions in late 2003 and again in 2004. It was then
16 that Mr. Cantilo testified that he did not research this
17 issue, but he simply assumed it. And it was in those
18 depositions that Mr. Cantilo testified that he assumed it -
19 assumed it based on a direct instruction from Mr. Hamje.
20 And he mentioned no other rationale for that assumption at
21 the time of his depositions.

22 Now, at the hearing, for the first time, Mr. Cantilo
23 curiously offers new theories for this assumption. He now
24 offers reasons for the assumption, which he failed to
25 mention in two rounds of depositions. Mr. Cantilo now

1 argues that there was an agreement, an agreement by Premera
2 for this notion that Premera is some form of charity or owes
3 fair market value.

4 And his support for this proposition? He has none. He
5 inferred it. And he made that inference notwithstanding
6 acknowledgment in his deposition that he knew this would be
7 a point of contention, not agreement, with Premera.

8 Now, how does he now claim to have inferred it? He says
9 the Form A talks about a transfer of 100 percent of
10 Premera's stock. He says, now echoed by Deputy Commissioner
11 Odiorne yesterday, surely that implies an intent to transfer
12 full market value.

13 But is that so? Is it credible that a sophisticated
14 transaction lawyer like Mr. Cantilo who has done so many
15 conversions would reach that conclusion ignoring other
16 provisions in the very same set of documents he is relying
17 on for the assertion? Could he only have read the
18 references to 100 percent of the stock while missing the
19 dozens, hundreds of pages of related document restrictions?
20 And is it conceivable that there is any basis for such
21 reliance when Premera has stated from the outset that it is
22 not a charity and the evidence has established that it has
23 not acted as one?

24 Commissioner, from the very first date Premera made
25 public its intent to convert and consistent with the

1 explicit language in its letter to you of May 2002 and to
2 the Attorney General on that same date, Premera has stated,
3 and consistently has stated, that it is not a charity.

4 Mr. Cantilo has also recently in the hearing asserted
5 for the first time, and, again, echoed yesterday by Deputy
6 Commissioner Odiorne, that Premera has an obligation to
7 transfer full fair market value because of its obligations
8 under its articles of incorporation. Mr. Steel earlier
9 today explained why, under Washington law, that new
10 assertion is also not tenable.

11 So, again, why all the discussion about a charitable
12 trust and fair market value? Absent such assumptions,
13 Premera is not obligated to offer and the consultants have
14 no basis to demand many of the rights they assert on behalf
15 of the proposed foundations.

16 Those assumptions cannot serve as a basis to deny the
17 conversion. Those assumptions cannot serve as a basis to
18 impose conditions on approval of the conversion.

19 Next, what is the real scope of difference between
20 Premera and the OIC consultants in this case? You heard,
21 Commissioner, in my opening statement we thought we had made
22 enormous progress in narrowing the issues in dispute on the
23 conversion application. And the testimony of most of the
24 OIC consultants echoes that sentiment. For example,
25 Mr. Alderson-Smith of Blackstone discussed in detail major

1 progress that was made in resolving many of the issues.

2 So how does that square with Deputy Commissioner
3 Odiorne's recommendations to deny the conversion or in the
4 alternative to condition an approval on the terms he
5 suggested? Let's take a closer look at the testimony of
6 some of the state's consultants as background to discussion
7 of Mr. Odiorne's recommendations.

8 Premera and OIC investment bankers concur on many
9 issues. Mr. Koplovitz of Blackstone, while expressing
10 concern about the size of Premera's portion of the IPO to
11 avoid concerns about dilution, otherwise had positive things
12 to say both about Premera and its proposed IPO.

13 For example, he acknowledged that Premera has a good
14 case for conversion in terms of bolstering its risk-based
15 capital and attaining financial flexibility. It is a good
16 time to go to market he says. The company has strong
17 fundamentals and would be an attractive IPO candidate.

18 Mr. Alderson-Smith of Blackstone concurred that Blue
19 marks are a valuable asset, that it would be imprudent to
20 jeopardize the Blue marks for the miscellaneous open
21 transaction terms. Also that while the value of the marks
22 is significant, he could not quantify value for the open
23 transaction terms. And he said they pale in comparison to
24 the value of the Blue marks.

25 He also expresses belief that many of the restrictions

1 in the Form A actually support the value of Premera's stock.
2 And when asked by you, Commissioner, to identify the most
3 important transaction terms which remain open, he noted two
4 in particular: Premera's board independence and foundation
5 voice at the Premera board through a board nominee.

6 Now, the differences between - the differences between
7 Premera and Blackstone on these points is narrow and neither
8 seems, to Mr. Alderson-Smith, an insurmountable obstacle to
9 achieving resolution. And he also expressed caution about
10 pushing the envelope too far with the BCBSA in a manner that
11 jeopardizes the Blue marks.

12 As to accounting and tax, the testimony of Mr. Tillett,
13 Mr. Ashley, Mr. Lundy, was all positive to the Premera
14 proposal. Mr. Lundy, in fact, concurred with Mr. Reid that
15 the transaction, quote, "serves the public interest by
16 permitting Premera to continue as a vital company with
17 access to public markets while unlocking the charitable
18 potential in its assets by adding two new large sources of
19 philanthropic health funding in the states of Washington and
20 Alaska," end quote.

21 As to market power, I previously discussed Dr. Leffler's
22 testimony. As to economic impact and the proposed
23 assurances, PwC consultants, headed by Ms. Hunt in the
24 discussions with Premera, participated in the design and
25 drafting of the proposed economic assurances. They confirm

1 at the close of those discussions that their only
2 reservations about those assurances is whether they should
3 extend beyond two years as proposed by Premera.

4 So given such testimony by the state consultants and the
5 good progress that was made by both counsel, Premera and the
6 state consultants themselves, how is it that Mr. Odiorne has
7 now come to his negative recommendations on the Premera
8 proposal?

9 On its face, Deputy Commissioner Odiorne's
10 recommendations are directly at odds with positions
11 expressed by the state consultants he himself retained. And
12 where was Deputy Commissioner Odiorne on these issues when
13 Premera and the consultants together with other
14 representatives of the OIC staff, at great expense to
15 Premera, labored for several months to reach agreement not
16 only as to concept on, but also the specific wording in
17 various transaction documents?

18 Let me give you a few examples of some of Deputy
19 Commissioner Odiorne's conclusions. He concludes the
20 conclusion would jeopardize Premera's financial condition.
21 That's in direct contradiction to the conclusions stated in
22 both the Blackstone and the Cantilo reports.

23 I spoke about the economic assurances. Deputy
24 Commissioner Odiorne also criticizes those economic
25 assurances, those same assurances the OIC staff and OIC

1 consultants helped structure, draft and approve as part of
2 the extensive instructions authorized by you, Commissioner.

3 And then Deputy Commissioner Odiorne reluctantly offers
4 in the alternative conditions, which he says he would
5 recommend if the Commissioner sees fit to approve the
6 conversion.

7 Premera actually has no objection to certain of those
8 conditions, but Premera strongly objects to others of those
9 conditions. For example, Mr. Odiorne proposes conditions,
10 which he and the consultants fully know squarely violate
11 Premera's Blue license and have never been approved before
12 by the BCBSA.

13 In fact, he even proposes to require Premera to
14 challenge the Blue Association's earlier decision on
15 Premera's petition to obtain the duplicate foundation
16 rights, which Mr. Barlow sought in good faith on behalf of
17 the state consultants.

18 Mr. Odiorne appears to accept Mr. Cantilo's pension to
19 take on the BCBSA as suggested in the Cantilo & Bennett
20 supplemental report. That is, in Mr. Alderson Smith's
21 words, to push the envelope. But to what logical end? To
22 extract from the Blue Association concessions that it has
23 never before agreed to? To risk a Maryland situation which
24 resulted in multi-jurisdiction litigation to the dismay of
25 all involved?

1 And who benefits from such a game of chicken? Not the
2 foundation, according to Mr. Alderson Smith. He stated that
3 the terms Mr. Odiorne wants to do battle on are of no
4 quantifiable benefit to the foundations, and, quote, "pale
5 in comparison to the value of the marks," and certainly not
6 to the benefit of Premera subscribers. Subscribers get
7 nothing by such conflict, even if there is some value to the
8 foundations.

9 Just look at the chaos the Maryland dispute caused to
10 CareFirst subscribers. And let's not forget that Deputy
11 Commissioner Odiorne's primary responsibility in this matter
12 is to subscribers and the insurance-buying public, not to
13 the foundations.

14 Those proposed conditions, which deviate from the Blue
15 Association rules, should be rejected outright. And while
16 this is not the place to go through each and every one of
17 the conditions he proposes and the issues they present,
18 Premera will do so in its posthearing brief.

19 Given Deputy Commissioner Odiorne's recommendations,
20 how does Premera propose to proceed now? Premera has sought
21 to address the consultants' concerns so long as those
22 concerns did not, one, threaten Premera's right to continue
23 to use the Blue marks and, two, undermine Premera's ability
24 to serve its current subscribers and the insurance-buying
25 public through its ongoing operations under the direction of

1 its board of directors.

2 Premera believes the Form A should be approved as
3 drafted. Premera also would accommodate the additional
4 technical corrections provided in Mr. Marquardt's testimony
5 and which were endorsed by Mr. Cantilo in his prefiled
6 responsive testimony.

7 Now, Premera may also be amenable to some of the new
8 concepts and compromises suggested by Mr. Alderson-Smith on
9 issues that he discussed with you, Commissioner, during his
10 live testimony. Some of those compromises sounded
11 reasonable and workable.

12 However, at this time, there is no mechanism for a
13 continued discussion between the parties in advance of your
14 decision. To fritter away the great process that has been
15 made to date would truly be wasteful.

16 Commissioner, I urge you to avoid that result. If
17 during the course of your review of the proposed conversion
18 and the administrative record, you come to believe that some
19 conditions are appropriate, I would ask you to call a
20 meeting of the OIC staff, Premera and the Intervenors to
21 review comments and discuss those proposed conditions
22 directly with you in advance of your final order. That
23 would give all parties the opportunity to understand what
24 conditions you find appropriate and to provide input to you
25 on those proposed conditions.

1 In closing, Commissioner, Premera's business is
2 capital-intensive. The innovations needed to help benefit
3 members require capital and that is precisely what this
4 conversion is designed to do.

5 And Premera has distinguished itself as a Washington
6 company known as an innovator in its field to the benefit of
7 its members. Premera's infrastructure in investments in
8 recent years and the Dimensions products and services which
9 resulted from those investments have been a resounding
10 success in the marketplace with Premera's subscribers.

11 We submit that conversion gives Premera the resources to
12 continue invest in the welfare of its current and future
13 members. It supports a Washington business that is emerging
14 as an innovative leader providing great service to its
15 community. At the same time, it creates a major endowment,
16 a truly great legacy to support the health of the residents
17 of Alaska through the foundations. And, finally,
18 Commissioner, we believe that this conversion meets the
19 requirements for approval under the Holding Company Acts.
20 Thank you.

21 JUDGE FINKLE: Thank you.

CLOSING ARGUMENT

BY MS. deLEON

MS. deLEON: Thank you, Commissioner, Judge Finkle, Ms. Sureau and Ms. Busch, for your time and attentiveness throughout this proceeding. After two weeks of live testimony, thousands of pages of experts' reports, and dozens of hours of depositions, it is now up to you to take a step back from everything you have heard and read to evaluate the appropriateness of Premera's request to convert, to essentially see the forest and not be limited to the trees.

It is the OIC's staff recommendation, that you deny Premera's request for conversion. In the event that you should be inclined to approve the conversion, then the OIC staff recommends significant conditions be placed upon that approval. Conditions that will be delineated a little later on.

To date, Premera has been championing this conversion from policyholder focus to investor ownership as a requirement for company survival because it brings with it access to equity capital to boost their RBC and for investments in technology and growth. However, it also brings with it a bottom-line orientation.

Premera has claimed that the infusion of equity capital

1 is critical to its future. However, a closer look at
2 Premera, as the OIC staff consultants have done over the
3 past two years, shows that Premera is a robust and vital
4 company that does not require equity capital to fund their
5 future. Their investments and service delivery, product
6 development and growth can continue to grow and be funded
7 through a combination of gains, through operational
8 efficiencies and investments and accumulated reserves,
9 access to ultimate capital sources and other nonequity
10 capital.

11 It is true that many Blues companies have converted over
12 the past few years yet only two remain public companies,
13 Anthem and WellChoice. It appears from this trend that as
14 soon as a nonprofit converts, its gets gobbled up by another
15 company and becomes part of a national conglomerate.

16 The OIC staff's responsibilities in this proceeding was
17 to ensure a proper evaluation of Premera's application for
18 conversion under the insure Holding Company Act, RCW
19 48.31(b), and the Holding Company Act for healthcare service
20 contractors and health maintenance organizations under RCW
21 48.31(c), which I will collectively call the Holding Company
22 Acts.

23 This has not been a simple task. It has spanned over
24 two years and many millions of dollars. The OIC staff
25 consultants reviewed a mountain of documents, interviews

1 with Premera's management, the management of Premera's
2 competitors, wrote initial and supplemental reports and
3 spent countless hours analyzing data. Suffice it to say,
4 they did as author as job as Premera would allow.

5 Their findings and conclusions can be found in their
6 final and supplemental reports, but let's walk through their
7 major findings and how they relate to the Holding Company
8 Acts and the OIC staff's recommendations to disapprove
9 Premera's application.

10 These major findings evolve around three major topics;
11 fair market value, adverse economic impact, and board and
12 executive management entrenchment. It is based on these
13 issues that the OIC staff recommends disapproval of
14 Premera's conversion application.

15 Let's look at the fair market value issue first. The
16 plans that Premera has to dissolve and distribute its assets
17 to the foundations are unfair and unreasonable to
18 policyholders and not in the public interest under the
19 Holding Company Acts.

20 Commissioner, don't be deceived by arguably
21 bait-and-switch tactics used by Premera to say whether the
22 Form A is based on the transfer of fair market values to the
23 foundations. Now is the time for Premera to commit just
24 exactly on what their intentions are, and something beyond
25 the vague term of 100 percent of the stock.

1 Contrary to Mr. Barlow's testimony, the transfer of
2 assets is not a gift. It is an obligation by statute and
3 their own corporate documents. Premera has an obligation
4 under the nonprofit corporation act and its own articles of
5 incorporation to distribute the assets of the corporation to
6 one or more nonprofit corporations.

7 Testimony from the Blackstone Group, the OIC consultants
8 investment bankers and Cantilo & Bennett, OIC's staff legal
9 expert, as well as Premera's own legal expert, Mr. Steel,
10 agree that transfer of 100 percent of the stock of New
11 Premera means transfer of fair market value.

12 Premera on the other hand, argues that they only have
13 the obligation to transfer the stock subject to the
14 restrictions. We beg to differ.

15 Premera's own documents belie the position that Premera
16 appears to take throughout this hearing. On Page 4 of
17 Premera's initial Form A, it states that the foundation will
18 correctively own 100 percent of the capital stock of New
19 Premera. On Page 9 of their initial Form A, it states the
20 foundation would receive 100 percent initial ownership of
21 New Premera. On Page 17 of Premera's plan of reorganization
22 and plan of distribution, it states Premera will dissolve
23 and distribute 100 percent of its assets consisting of the
24 stock of New Premera to the foundations. And on Page 3 of
25 Exhibit 7 to the state's Exhibit S-86, the Preston Gates

1 letter to John Hamje dated October 15th, 2003, it states
2 Premera has only agreed that it will transfer 100 percent of
3 its stock to the foundation shareholder which represents the
4 fair market value of the company upon consummation of the
5 conversion transaction.

6 The testimony of Premera's witnesses have only served to
7 muddy the view of this issue. But, then again, let me bring
8 you back to what Mr. Steel said when asked whether
9 transferring 100 percent of Premera's stock was equivalent
10 to the transfer of fair market value. He stated, "I
11 suppose. Yes."

12 However, these assets, we have learned, come with
13 strings attached. One might even argue that what Premera
14 appears to give with one hand, they take away with the
15 other. The strings in this proceeding take the form of
16 restrictions on when the stock can be sold, how to sell that
17 stock and the rights accompanying the stock.

18 These strings have served as a substantial impediment to
19 the transfer of fair market value of the stock to the
20 foundations. Because of these strings, Premera's plans to
21 dissolve and distribute its assets to the foundation are
22 unfair and unreasonable to policyholders and not in the
23 public interest as required under the Holding Company Acts.
24 The conversion should be disapproved based on this issue
25 alone.

1 Now, Premera has attempted to hide behind the Blue
2 Cross/Blue Shield Association by presenting excessive
3 amounts of testimony about the restrictions placed upon them
4 by the Association and how discarding the Association's
5 restrictions could result in the loss of their Blues mark.

6 First, we would point out that these restrictions are
7 reportedly imposed by the Association, but they are not in
8 the license agreement or any other document.

9 Second, and more important, this is not your concern,
10 Commissioner. You are not bound by what the Association
11 requires or doesn't require in this conversion. This is an
12 issue of choice, not a game of chicken. Not a choice you
13 must make. A choice Premera must make. The Association is
14 not before you. It is not a party in this proceeding. It
15 is not and should not be controlling and has absolutely no
16 authority to act or influence you. You must make your
17 decisions free from any influence of the Association and
18 then let Premera choose its path.

19 In the event that you decide to approve the conversion
20 and agree with the conditions the OIC staff recommends, then
21 it is up to Premera to decide whether it can live with those
22 conditions. This may be - this may include an analysis of
23 the steps that need to be taken with the Association or
24 possibly more negotiation with them or whether to pursue the
25 conversion and risk the loss of their mark.

1 Premera's plans or proposals to dissolve are unfair and
2 unreasonable to subscribers of healthcare and not in the
3 public interest and are likely to be hazardous to the
4 insurance-buying public under the Holding Company Acts.
5 Despite Mr. Barlow's reluctance to agree today, Premera has
6 agreed that for-profit companies shift their focus to the
7 best interests of the subscribers to their own bottom line
8 and shareholders investors.

9 You have heard from the investment bankers and legal
10 consultants saying that investors want to see profits
11 increase and stock values rise. Investors also demand
12 positive quarterly increases. It is against these
13 performance measures that Premera will be gauged by their
14 investors and in the marketplace.

15 However, Premera wants you to believe that it will not
16 raise rates above trend. In fact, it has provided a set of
17 economic assurances that it will implement for two years in
18 which it promises not to raise rates above trend for its
19 current product line. As Mr. Odiorne testified, any kind of
20 economic assurances could jeopardize Premera's financial
21 standing.

22 If you are, however, inclined to approve the conversion,
23 then these assurances simply don't go far enough. In fact,
24 as you heard from Ms. Lichiou Lee, these assurances can be
25 sidestepped by offering new products that are substantially

1 similar to existing products but without any of the
2 restrictions. So just how good can those assurances be?

3 Evidence exists to demonstrate that Premera has already
4 begun changing their behavior to mirror a for-profit
5 company. PricewaterhouseCoopers forewarned in their October
6 25th, 2003, economic impact report that Premera would have a
7 greater incentive as a for-profit to exit certain low-income
8 programs if financial performances deteriorates.

9 Not surprisingly, just prior to the anticipated
10 conversion, Premera stated that it is exiting two programs
11 specifically mentioned by PwC as potential targets for
12 elimination, including Healthy Options and the Basic Health
13 Plan. Moreover, at the time of the PricewaterhouseCoopers'
14 report, Premera indicated that it would exit the PEPB
15 account effective January 2004.

16 Now, these withdrawals could be viewed as purely
17 business decisions that would be made regardless if Premera
18 was for-profit or not-for-profit. On the other hand, they
19 could be also viewed as Premera's attempt to position itself
20 as a more profitable, for-profit company in order to make
21 the company more marketable to public investors.

22 Additionally, many of Premera's executive compensation
23 plans have been amended in the last two years, providing
24 additional benefits to the management team, as noted in
25 PricewaterhouseCoopers' executive compensation report. Most

1 importantly in 2001, near the time conversion discussions
2 began, Premera added a change of control provision that
3 would provide additional significant compensation upon a
4 sale or merger.

5 Although Premera did amend the plan to indicate that a
6 conversion would not trigger such payments, this may be
7 evidence that Premera will simply follow the long trend of
8 Blue conversions that result in a merger a few years after
9 the conversion, which ultimately trigger these lucrative
10 change of control payments.

11 You also heard from PricewaterhouseCoopers that the
12 conversion could increase rates for the small group and
13 individual markets in Eastern Washington. The possibility
14 of that risk is simply unacceptable.

15 Because of the risk of board and management
16 entrenchment, those persons - those persons who would
17 control the operation of the health carrier, it would not be
18 in the interest of subscribers of the health carrier and of
19 the insurance-buying public to permit this conversion under
20 the Holding Company Acts. Despite the mountain of testimony
21 that falls within the
22 we-are-a-wonderful-management-group-just-trust-us, the OIC
23 staff testified that this conversion serves to entrench the
24 current board.

25 First, as Mr. Nemerov and the Blackstone Group

1 testified, Premera's executives and their board stand to
2 make an enormous amount of money after this conversion.
3 This money is made by the issuance of stock options. Again,
4 despite the incredible testimony of persons such as Brian
5 Ancell, these board members and senior management are in a
6 position to be recipients of major financial gains when
7 these options are exercised.

8 Next, the Association rules themselves have the same
9 effect towards maintaining the current managers and board in
10 their positions. The Association license agreement states
11 the plan's license to use the license marks and names shall
12 automatically terminate effective 10 business days after
13 individuals who at the time the plan went public constituted
14 the board of directors sees for any reason to constitute a
15 majority of the board of directors. New Premera's articles
16 of incorporation are also designed to entrench the current
17 board.

18 As an individual to be nominated by a shareholder, a
19 shareholder or shareholder group must be the owner of more
20 than five percent of the corporation's capital stock for a
21 continuous period of at least two years. So for the first -
22 so first, the shareholder must have owned stock for at least
23 two years and it must have more than five percent.

24 We know that the Blue Cross/Blue Shield Association
25 restricts individual ownership to less than five percent, so

1 almost by design this can never be fulfilled unless a group
2 of shareholders or an institutional shareholder with a
3 holding of at least five percent after two years, they
4 cannot nominate a director.

5 Also in their - under the same article, if there is more
6 than one nominating shareholder eligible to nominate a
7 director, only the nominating shareholder with the largest
8 beneficial ownership shall be permitted to nominate a
9 director. So only one shareholder at a time can nominate a
10 director.

11 Also under this section, this only applies to vacancies
12 at the termination of a director's term. Any newly created
13 directorships or vacancies resulting from the removal,
14 resignation or death of a director shall be filled by an
15 affirmative vote of the independent majority. So that
16 provision circumvents the shareholder all together.

17 Premera has also built into its proposed articles of
18 incorporation, both for New Premera and the foundations,
19 mechanisms that give existing board members control over
20 people that fit in with the current demographic by allowing
21 the current board to veto all of the foundations' proposed
22 nominees. Remember that Ms. Jewell and Mr. Marquardt both
23 testified that the right chemistry was important for board
24 members.

25 For the past two weeks we have heard that the reason

1 Premera wants to convert is to gain access to capital
2 through their equity markets, but as you also heard, there
3 is another way to raise capital, through a sale or merger.
4 But Premera has been adamant that they rejected the
5 possibility of a sale or merger because they wanted to
6 maintain local control and independence, but they fail to
7 even define these terms for the proceeding.

8 If by "local," Premera means that subscribers or
9 consumers want only to deal with companies whose corporate
10 headquarters is also located within their same state,
11 Premera has provide no evidence to that theory. On the
12 contrary, they have a significant portion of their business
13 in Alaska. And it was clear from Premera's testimony, that
14 they are activity growing in Oregon and Arizona. Both of
15 these are outside the State of Washington.

16 If their theory holds true, then why would you want to
17 grow outside of Washington State? In fact, Ms. Donigan
18 testified that Premera lost the bid for the Washington
19 Mutual account to out-of-state nonBlues competitors, so
20 local management was not such an important factor for
21 Washington Mutual.

22 Premera's expert, Ms. Novak, was very candid about this
23 issue. She testified about several success stories
24 regarding sales to other health carriers, such as Anthem,
25 where the acquired company did much better after they were

1 acquired. So their argument that loss of independence and
2 local control are the reasons not to sell or merge just
3 don't jive with their own testimony. I submit to you that
4 the reason they do not want to consider a sale is because
5 they do not want to lose their jobs.

6 The insurance-buying public and current members do not
7 need another health carrier with a bottom-line mentality.
8 Premera has for the past two weeks testified over and over
9 again that we need more capital, but could not provide even
10 one example of projects they have not been able to fund due
11 to capital constraints.

12 Sure, they have to update and maintain IT systems. What
13 business doesn't? Sure, they have to update and maintain
14 product lines. What business doesn't it? Every business is
15 faced with trade-offs and priorities.

16 Premera has already funded a complete overhaul of their
17 product line with the Dimensions product. Premera has
18 already budgeted for IT maintenance. Premera has already
19 budgeted for a disaster recovery plan. So their express
20 need for capital just doesn't ring true.

21 They also argue they need more capital targeting a 500
22 percent RBC rather than the current 433 percent, but they
23 have managed to get from 406 to 433 percent while this
24 process has been pending just from internal growth.

25 As Mr. Koplovitz told you a week ago, the 30 million

1 dollars they have spent on the conversion before the hearing
2 would have put them at 450 percent, and that's almost to
3 their goal in less than the past two years.

4 As we said in our opening statement, this is no
5 run-of-the-mill Form A. In fact, the Blackstone Group
6 testified it was truly an unusual deal and that normally a
7 company has a list of projects that needs to be funded and
8 they limit their capital needs to the amount required by
9 those projects.

10 In this case, however, Premera has determined that it
11 needs 100 to 150 million dollars but has been unable to
12 provide the Blackstone Group with any list of projects that
13 Premera wanted to fund with the new monies. Instead, they
14 state they will invest it in four percent bonds until we
15 decide how to spend the money.

16 Now, you must ask yourself why would an investor invest
17 in that company, where their money will be invested in a
18 four percent bond, something the investor could do
19 themselves? Well, as Blackstone testified, no investor
20 would.

21 Premera came to the state requesting to convert from a
22 nonprofit to for-profit in exchange for transferring all of
23 their value to the foundations. Now it turns out it is not
24 all of their value. And there are deep concerns about this
25 conversion. The OIC staff recommends, however, that if you

1 are inclined to approve Premera's application, the OIC staff
2 submits that you do so only with the following conditions:

3 Condition the closing on the approval of the Alaska and
4 Oregon Insurance Commissioners and any required action by
5 the Washington State Attorney General with 85 percent of
6 Premera's assets transferring to the Washington foundation
7 and 15 percent to Alaska.

8 Eliminate the requirement for the foundation to sell
9 down to 80 percent of the outstanding stock by the first
10 year. Blackstone Group has testified that the six-month
11 lockout period and any adverse markets could significantly
12 impact the foundation's ability to sell stock within the
13 first year. A forced sale just to get to an arbitrary
14 percentage is foolish.

15 Allow each of the foundations minus one share of stock
16 outside of the voting trust. Each foundation is a separate
17 legal entity, with unique goals, serving a distinct group
18 and governed by different boards and these foundations
19 should not be forced to share this five percent vote when
20 each is clearly a separate shareholder.

21 Remove the ten percent force sale of the foundation
22 stock at the IPO as currently required in the unallocated
23 shares in the escrow agent agreement. There is absolutely
24 no requirement for this restriction that would force the
25 foundations to sell quickly and at a discount.

1 Let the foundations make their own decisions.

2 Uncouple the foundations divestiture schedules and make
3 them separate and stand-alone schedules. All I can say
4 about this is how can they pretend that the States of Alaska
5 and Washington are one entity?

6 Eliminate Premera's ability to veto all of the
7 foundation's directors nominees. Their argument that this
8 restriction is necessary to ensure board chemistry is just
9 plain offensive and totally unnecessary. The criteria laid
10 out for a board nominee, which only applies to our director,
11 is restrictive enough to ensure that at least one of the
12 three nominees would be suitable.

13 Retain the foundation's board representation until its
14 ownership falls below five percent without adding a time
15 limit.

16 Eliminate the voting trust and divestiture agreement if
17 Premera loses its mark or doesn't need to preserve the mark.

18 Eliminate the automatic extension of the closing date
19 beyond one year. They can come to you if there is good
20 reason.

21 Require approval of the solicitation application.

22 Require adequate tax comfort as described by
23 Mr. Odiorne.

24 Condition the conversion closing fairness and IPO
25 procedures opinion by the Blackstone Group and certificate

1 of no material change.

2 Require that foundations have the right to vote on more
3 than 20 percent change in control.

4 Ensure that Washington is afforded the same guarantees
5 as Alaska.

6 And require compliance with any other conditions the
7 Commissioner may decide to impose after considering the
8 experts' reports and the record in this case.

9 When you evaluate what is the right and lawful course of
10 action here, you must see that it isn't just about Premera
11 wanting to access more capital. You must look beyond
12 Premera and to the citizens of the State of Washington who
13 are wondering whether or not they are going to have
14 affordable healthcare.

15 At the end of the day, you need to listen to the folks
16 who came to your public meetings and told you what they
17 thought. The OIC staff has presented you with the facts and
18 figures that you need to support the thoughts of those
19 individuals.

20 It is more than just dollars and cents. It is more than
21 just stock options and golden parachutes. It is about
22 Elizabeth from Bainbridge Island, who is a single mother and
23 a Premera consumer who wonders if she is going to have
24 healthcare. It is about Jerry from Omak, Fred from
25 Wenatchee and Frank from Anacortes, all of whom sent you

1 letters and e-mails asking that you look out for their best
2 interests and deny Premera's application to convert.

3 Thank you.

4 JUDGE FINKLE: Thank you.

5
6 CLOSING ARGUMENT

7 BY MR. MADDEN

8 MR. MADDEN: Commissioner Kreidler, on behalf of all
9 the Intervenors, and in particular, my clients from the -
10 from the Washington hospitals, I want to thank you for the
11 opportunity that you afforded us to participate in these
12 proceedings. I hope that our presentation has been helpful
13 to you as you decide this very important case.

14 We agree with Premera that it is a very important case,
15 although we think it is important for slightly different
16 reasons. The reason that we think it is so important is
17 because --

18 JUDGE FINKLE: Do you want to shift --

19 MR. MADDEN: I'm going to shift to the other one
20 here.

21 The reason we think it is so important is because
22 Premera now proposes to abandon the last vestige of its
23 original mission. That mission is set forth in the original
24 articles of incorporation of the original Blue company in
25 this state, which is Intervenors Exhibit 6 and in, for

1 example, Intervenor's Exhibit No. 9, the premerger articles
2 of Premera of the Medical Service Corporation of Spokane.

3 Those articles stated that purpose of the company was to
4 promote the social welfare and to secure for wage earners
5 and their families health service including the benefits of
6 surgical care treatment, hospitalization and nursing of
7 which many of such individuals and their families might
8 otherwise be deprived. That's why we think this is such an
9 important proceeding.

10 These goals will be lost, or if not lost, they will have
11 to compete with the goals of Wall Street if conversion is
12 allowed. Because regardless of how much Premera denies it
13 or says that hospitals themselves behave like businesses,
14 there is a fundamental difference between not-for-profits
15 and publicly-traded companies.

16 And that difference is as Mr. Barlow finally - and, I
17 think, in a fit of candor - admitted to you this morning, is
18 Wall Street. Because after conversion there will be a new
19 load placed on Premera. And that load consists of the
20 margin that it must grow in order to satisfy Wall Street.
21 Two percent simply won't cut it.

22 Now, where will that margin come from? Or to put things
23 more in focus for these proceedings, where can that margin
24 come from without harming the public interest or without
25 prejudicing the insurance-buying public?

1 Well, first of all, we know that that margin is not
2 going to come from increased efficiency. Because you heard
3 the statements of other companies and their general and
4 administrative expense allowances are comparable to
5 Premera's, whether they are for-profit or not-for-profit.

6 We did hear that it may come from rate increases.
7 Premera has set target margins for its individual and small
8 group businesses that it is not meeting. And this morning,
9 Mr. Barlow told you that it has been the company's
10 philosophy, which it has apparently been gradually
11 implementing from 1997, that each line of business must
12 carry its own load. That is, after all, Wall Street's
13 expectation.

14 It may also be that Wall Street's expectations will be
15 satisfied through product design and underwriting practices
16 that will provide more restrictive, less risky coverage to
17 younger, healthier and wealthier persons. But most likely,
18 based on the evidence in the Carl Shram (phonetic) report
19 that was discussed and presented in Maryland and the very
20 real undisputed evidence from California that was presented
21 to you, that margin is going to become - is going to come
22 from reduced medical payments.

23 If you consider that Premera's premium revenues were
24 about 2.5 million annually and that it has a medical loss
25 ratio of about 84 percent, that means it pays out about 2.1

1 billion in healthcare annually. If you adjust that medical
2 payment ratio to 78 percent, consistent with the California
3 experience, that means that there is a loss of 150 million
4 dollars per year in healthcare payments, which I submit to
5 you is a drop in the bucket compared to the projected
6 benefits of the Washington foundation.

7 And this, indeed, may be the answer to Mr. Milo's
8 question, why all the fuss about fair market value and
9 charitable trust. Because the very real evidence before you
10 suggests that there will be a cost - an inevitable cost in
11 terms of reduced compensation and payment for healthcare in
12 this market as a result of conversion.

13 But I can also suggest to you some other reasons why all
14 the fuss about fair market value. One of those you can find
15 in Intervenors Exhibit 1, which is the May 30th, 2002,
16 letter to Attorney General Gregoire in which they pointed
17 out to here that the proposed conversion required certain
18 regulatory approval, including hers. And her approval was
19 required under the Not-For-Profit Corporation Act.

20 And while the lawyers who - or perhaps Mr. Milo, who is
21 lawyer who signed that letter - whoever wrote it thought
22 they may have thought they were being clever in the way that
23 they couched it. You heard Mr. Steel, the corporate law
24 expert for Premera, say that the Attorney General has no
25 other jurisdiction to approve this conversion than under RCW

1 24.03.230 and 225. So why did they submit it to her? Well,
2 they submitted it to her - we know this from Exhibit I-5,
3 the notes of Mr. Barlow's presentation to his top managers
4 given just a few days later - that there was going to be a
5 fight as there had been in other states about whether
6 Premera was impressed with a charitable trust.

7 And they come up with a clever solution. They said, you
8 know, we are going to avoid all that because we are going to
9 act just like we are a charity as a practical matter. It
10 won't make a difference because we are going to offer the
11 full asset value as represented by 100 percent of the stock
12 to the public.

13 Well, you found out that when you push them a little
14 bit, that, all of a sudden, there are problems. But I
15 reiterate what Staff's counsel has said: Premera structured
16 the deal, they have to live with it.

17 Premera also makes the point that there is a burden of
18 proof on the Staff and the Intervenors to make out
19 conditions permitting disapproval and then they say that all
20 the evidence we presented is speculative. Well, let me
21 point out that the standards under the Holding Company Acts
22 require you to predict the future behavior of the company.

23 What is the best predictor of Premera's future behavior?
24 Well, perhaps, some of the behavior that it has exhibited
25 since it came up with the idea to convert, Certainly, the

1 experience of converted Blue plans in other states, and,
2 finally, your expertise and technical knowledge as a
3 regulator about the behavior of insurance companies and
4 publicly traded corporations. And when you bring all that
5 to bear, this does not become such a complicated question.

6 Let me just point out to you a critical piece of
7 evidence in this case and that is the experience that is
8 closest to home for us in California. You heard
9 Mr. Dauner's testimony about the effects of conversion in
10 California. You did not hear Premera dispute it, even
11 though they have known for months that it was coming.

12 What has happened in California is that cartelization of
13 healthcare. It has resulted in higher premiums, more
14 uninsured and lower payments for healthcare.

15 We, Washington hospitals, don't believe that we need
16 those problems in Washington. We have had a predominantly
17 not-for-profit health insurance market in this state.
18 Conversion is so likely to change that landscaping in
19 undesirable ways that you should have before you a record
20 that fully and fairly meets the evidence of likely
21 prejudicial effects that has - is before you should you
22 consider approving such a request.

23 This case - that case, however, the case that - to rebut
24 the evidence of prejudicial effects, just as in Kansas, has
25 not been made. The evidence before you clearly permits the

1 informed prediction that you are required to engage in under
2 the Holding Company Acts. That conversion is likely to be
3 hazardous or prejudicial to the insurance-buying public.

4 Mr. Commissioner, I don't think we need the problems of
5 California. We have a system and, indeed, the testimony
6 shows a company that is functioning quite well as is. And
7 on the record before you, we ask you to deny the
8 application.

9 Thank you.

10 JUDGE FINKLE: Thank you.

11
CLOSING ARGUMENT

12 BY MR. COOPERSMITH

13
14 MR. COOPERSMITH: We have heard from a lot of the
15 economists, consultants and lawyers, and we have lived to
16 tell about it. We have seen a lot of PowerPoint slides from
17 Premera and expert reports and financial projections. There
18 was only one thing missing from Premera's presentation,
19 reality.

20 The reality here is that the people with the most at
21 stake were never at this hearing. They are the patients of
22 Washington State, not the ones who can afford to get the
23 finest care whenever and wherever they want, but everybody
24 else. The people who can't afford to get sick or have their
25 kids get sick. These are the people that need you,

1 Mr. Commissioner.

2 The WSMA tried to make sure that their voice was heard
3 at this proceeding. You see, we don't need \$500-an-hour
4 consultants flying in from around the country to tell us
5 what is going on in our own backyard. All we have to do is
6 open the doors to a doctor's office and take a good look
7 around.

8 Dr. Collins helped us to do just that. He sees 300
9 patients in a month; children with chronic asthma, women
10 with heart conditions, seniors with diabetes, patients who
11 can't come to him. He goes out and sees inmates with HIV,
12 drug addicts at the Deaconess hospital, sick patients at
13 Sacred Heart. The very day he testified, Dr. Collins had
14 been seeing patients in the hospital that morning at 5:00
15 a.m.

16 But Dr. Collins' only dreams of being able to treat his
17 patients all day long. Instead he is forced to take time
18 away from his patients, time to deal with Premera. He
19 testified how Premera interferes with patient care, how he
20 recently tried to help a patient suffering from the loss of
21 muscle mass and bone density, but Premera refused to cover
22 the needed procedure. He told us how the care was denied
23 not by a Premera physician, but by a licensed practical
24 nurse.

25 Dr. Collins eventually got approval for the care, but

1 only after fighting the Premera bureaucracy. That's the
2 same Premera bureaucracy that tells Dr. Collins and his
3 colleagues, you know, "Our computers just don't talk to each
4 other. I don't know which department handles that," and
5 increasingly, "We can't make that decision in Spokane
6 anymore, you have to talk to headquarters."

7 Dr. Collins also testified about Premera's new so-called
8 voluntary benefit advisory. Oh, it's voluntary all right.
9 You don't have to get one. Of course, you don't have to get
10 paid either. And as Dr. Collins showed, there is no
11 guarantee when you will hear back. He is still waiting for
12 a final decision on a medication weeks after he asks. And
13 the new system makes no guarantee of payment. It says so
14 right on the form.

15 Premera boasts that it has done away with the old
16 requirement for preauthorizations for care. Instead,
17 Premera has managed to make a bad thing worse.

18 Dr. Collins also told us how Premera tries to get
19 physicians to prescribe certain drugs, not because they are
20 better for the patient, but because they are better for
21 Premera's bottom line. Even when Dr. Collins' patients are
22 suffering from side effects, Premera wants them to pay more
23 if it is not a so-called preferred drug. Oh, yes, Premera
24 says it has an open formulary. Open, that is, to anyone who
25 can afford it.

1 Now, you would think that Dr. Collins would have some
2 clout with Premera. After all, he has been taking care of
3 people in Eastern Washington for nearly 20 years. He is the
4 only physician in Spokane to be named to every edition of
5 America's Best Doctors. He was head of the Spokane Medical
6 Society and now is the head of the Washington State Medical
7 Association.

8 And certainly you would think that Dr. Collins would
9 have some clout because he practices with 20 other primary
10 care physicians, making it one of the largest clinics in the
11 region. But no such luck, not with Premera. Premera gives
12 Dr. Collins' clinic the same take it or leave it contract it
13 forces upon 70 percent of all physicians in Washington and
14 66 percent of all physicians throughout the state.

15 And what an abysmal contract it is. An average increase
16 in reimbursement of 4.7 percent per year, not even enough,
17 as Dr. Collins showed, to cover the annual increase in
18 operating expenses at his clinic.

19 What does he make? Well, Dr. Collins makes an average
20 of \$46 an hour. That's less than the plumber just charged
21 me last weekend to fix the toilet and less than a tenth of
22 what the average Premera expert seems to be charging for
23 this hearing.

24 Because of inadequate reimbursement, as Bob Perna,
25 WSMA's Director of Healthcare Economics testified, our state

1 is finding it harder and harder to attract and retain
2 physicians and are seeing more and more physicians retire
3 early. Because of inadequate reimbursement, as both
4 Dr. Collins and Mr. Perna testified, physicians are no
5 longer able to afford to provide care to as many uninsured
6 and underinsured patients as they did before.

7 When the cost of care is higher than the payment for
8 that care, the entire system is in peril. It bears
9 repeating. When the cost of care is higher than the payment
10 for that care, the entire system is in peril.

11 So why would Dr. Collins sign such a lousy contract with
12 Premera? Why would so many of his colleagues sign such
13 lousy contracts and why, for that matter, would physicians
14 tolerate such unjustifiable findings by Premera into the
15 exam room and the operating room? Why? Because they have
16 no choice.

17 As Dr. Collins testified, Premera accounts for half of
18 all patients with private insurance coverage at his clinic.
19 Half. The next closest is PHCO with five percent. That's
20 the reality in Eastern Washington. It is very different
21 from the picture that Mr. McCarthy paints.

22 Mr. McCarthy, who was the chief expert from Premera on
23 the impact on patients and the physicians and hospitals
24 who - Mr. McCarthy, who used companies that were not even
25 health insureds as examples of competitors to Premera,

1 Mr. McCarthy, who used companies with a one and two percent
2 market share as examples of robust competitors for Premera.
3 And, you know, after all the testimony that Premera has
4 given in this proceeding about how absolutely critical it is
5 to have the Blues marks, how interesting it is that they
6 want us to believe that Regence is a competitor to them in
7 Eastern Washington where Regence does not have the Blues
8 mark. Regence is known there as Asuris, which has always
9 sounded like a terrible skin condition to me.

10 Now, Mr. McCarthy's conclusion should come as no
11 surprise. He never spoke to a single physician in our
12 state, not to a single hospital or to any of Premera's
13 competitors. He has never even set foot in Eastern
14 Washington. Perhaps, that's why he can see no difference
15 between the healthcare market in Eastern Washington and the
16 healthcare market in Western Washington.

17 Premera already has too much power. Why give the
18 company more? By becoming for-profit, Premera would be
19 legally obligated to put profits before patients. Now, the
20 WSMA is not ideologically opposed to the for-profit as
21 Mr. Milo suggests.

22 Dr. Collins' own clinic is a for-profit, or at least it
23 is trying to be. The difference is for Dr. Collins and for
24 his physician colleagues is that they have an ethical
25 obligation to take care of their patients regardless of the

1 cost, but Premera does not have such an ethical obligation.
2 Their obligation is to the shareholders. Shareholders from
3 across the country that won't be demanding care for
4 Washington residents. They will be demanding a return on
5 their investment.

6 So what would happen if Premera were allowed to put
7 profits before patients? They would be likelier, even
8 likelier, to erect more administrative barriers to care.
9 Premera would be even likelier to drive down reimbursement
10 rates even further. Premera would be even likelier to raise
11 premiums even higher. Premera would be even likelier to
12 abandon unprofitable markets.

13 Dr. Collins told us what happens when premiums rise.
14 Patients defer care. Patients are more likely to seek care
15 over the phone. They are less likely to get needed
16 follow-up care and they are more likely to end up in already
17 overcrowded emergency rooms.

18 Mr. Perna explained what happened when Premera withdrew
19 from the individual market. It left people unable to -
20 unable to find replacement coverage and caused more people
21 to show up at emergency rooms across the state.

22 Now, Premera promises not to withdraw from rural areas.
23 In fact, it promises it won't act any differently as a
24 for-profit than it does now as a nonprofit. But
25 unfortunately, Premera just doesn't have a good record when

1 it comes to keeping promises.

2 Mr. Perna showed us how to scrutinize Premera's
3 assertions more closely. Premera says it has a good record
4 of paying claims promptly. Mr. Perna asked, how many
5 partial payments and underpayments are counted in that
6 number? And, by the way, who decides what constitutes a
7 clean claim? And what about wrongful denials?

8 Premera says it has eliminated the need for referrals.
9 Mr. Perna asks why then does Premera states on its own
10 website that referrals are still required under certain
11 circumstances?

12 Premera says that its new care facilitation program will
13 do wonders for patients and physicians alike. Mr. Perna
14 noted that care facilitation could turn out to be code for
15 cost containment in which Premera decides what care will be
16 provided and when.

17 Finally, Mr. Perna conveyed the fear of so many
18 Washington physicians, that Premera is merely positioning
19 itself for an out-of-state acquisition.

20 The WSMA won't comment further on the many financial
21 issues before you, Mr. Commissioner, except to make this one
22 observation: As a for-profit, Premera would be required to
23 cut spending and raise revenue aggressively. Are they
24 really going to hire the best sales and marketing force, the
25 best underwriters and the best office managers in the

1 industry, better than any of their competitors, or is
2 Premera going to go after the real money, the 84 cents of
3 every dollar it spends on payment for healthcare services?

4 Deputy Commissioner Odiorne did his usual, methodical,
5 meticulous analysis of the financial assurances. I
6 understood most of it, except for the nuance. Even if I
7 could grasp all of the nuances, I know that with
8 Mr. Odiorne's expertise and experience, that part of the
9 transaction has been ably and fully vetted.

10 In closing, I simply want to do what I do best, which is
11 point out the obvious. This is no mere financial
12 transaction under review. This is not just about stock
13 options and evaluation. This is about whether we would risk
14 the health needs of the many for the financial benefit of
15 the few, a very few.

16 Commissioner, physicians must follow the hypocratic
17 order. First, do no harm. That approach, I know, would
18 sure transform the legal profession, but it seems to be
19 pretty good guidance for regulators, too. First, do no
20 harm.

21 The Washington State Medical Association respectfully
22 requests that you reject the Premera conversion proposal for
23 the sake of the 9,000 physicians that the association
24 represents and especially for the sake of the millions of
25 patients they treat who could not be with us here today.

1 Thank you.

2 JUDGE FINKLE: Thank you.

3

4 CLOSING ARGUMENT

BY MS. McCULLOUGH

5

6

7 MS. McCULLOUGH: Okay. First, thank you very much,
8 Commission Kreidler for allowing the Alaska --

9 JUDGE FINKLE: You need to get a bit closer to the
10 mic.

11

(Brief discussion off the
12 record.)

13

14 MS. McCULLOUGH: I guess I will just hold it, as
15 awkward as that might look.

16 The OIC staff has asked the Commissioner to disapprove
17 the conversion and the Washington Intervenors have also
18 asked the Commissioner to disapprove the conversion. The
19 Alaska Intervenors also now ask the Commissioner to
20 disapprove the conversion. And while we have - may all have
21 reached the same conclusion for different reasons, I think
22 that there is one important and common thread here and that
23 is the lack of peace of mind that comes with this
24 conversion.

25 The conversion simply does not provide peace of mind to

1 the subscribers about their continued access to affordable
2 healthcare, to providers about maintenance of adequate
3 reimbursement levels or to the public about whether the
4 foundations would be fully funded and free to maximize the
5 assets they are to receive to address the vast healthcare
6 needs of Washington and Alaska.

7 Due to the fundamental problems surrounding the
8 government's structure of the foundations and unresolved
9 issue of fair allocation of Premera's assets between
10 Washington and Alaska, the Alaska Intervenors believe that
11 this conversion does not, nor can it, provide the peace of
12 mind necessary for the Commissioner to approve this
13 conversion. Indeed, the allocation itself presents an
14 insurmountable benefit in its own form.

15
16 To briefly explain, Premera's proposal is premised on -
17 in large part, on the notion that both Washington and Alaska
18 will benefit from the conversion due to the creation of two
19 foundations that will receive some portion of its assets.
20 So this much we know. But what we don't know is what is
21 the worth of those assets and whether they might be worth
22 more if they are not subject to the litany of restrictions
23 that Premera has proposed they be subject to.

24 And as Mr. Koplovitz testified, nothing prevents the
25 value of Premera from being determined before your decision

1 is made. And what we also don't know is what portion of
2 these assets either state will actually receive. These are
3 two fundamental unknowns that must be answered before you
4 can determine that the conversion is in the public interest.

5 In other words, how did the - I'm sorry - how can the
6 Commissioner have any peace of mind about whether this
7 conversion is in the public interest when it has no idea how
8 much the Washington foundation will actually receive and
9 whether the amount that it receives will be enough to
10 mitigate against the very really negative impacts attendant
11 with this conversion.

12 As we have seen among the experts who have tackled the
13 allocation issues, there is room for disagreement. In fact,
14 there is a substantive disagreement between the Washington
15 experts and the Alaskan experts. This is not simply a
16 matter of Alaska saying we want more, even though, of
17 course, we do.

18 As the evidence has shown, a genuine dispute exists
19 between the experts about the appropriate methodology and
20 the factors to be considered when analyzing the issue of
21 allocation. And with all due respect to the OIC staff
22 experts, Mr. Koplovitz and Mr. Staehlin, there is
23 insufficient evidence on the record to support the award to
24 Washington that they have recommended.

25 I won't get into the details of the errors in their

1 findings. We will save that for our posthearing brief, but
2 let me just point out a couple of noteworthy things.
3 Mr. Staehlin's report contains qualitative factors that he
4 considers additional considerations. He has been unable to
5 demonstrate how they are even quantified, yet these factors
6 account for as much as six percent of the total
7 recommendation range.

8 One of these additional considerations or factors is the
9 IPO participation fee. Now, Mr. Staehlin proposes that
10 Alaska be charged to participate in a joint IPO. This
11 despite the fact that there is only one IPO contemplated and
12 that's for the entire holding company, not for the separate
13 divisions nor for the separate lines of business.

14 In addition, he concludes that Alaska should have to pay
15 five million dollars to participate in this IPO. This
16 despite the fact that he can't even tell us how much the IPO
17 might actually cost.

18 Mr. Staehlin also claims that this factor equals between
19 zero and two percent of the total value of Premera. This
20 despite the fact that the total value of Premera is unknown
21 . And, interestingly, the allocation range without this
22 IPO fee is 82 to 88 percent and with this IPO fee, the range
23 is still 82 to 88 percent. It just doesn't add up.

24 And if I could just make one final point, and that's
25 about the foundations. We believe that for the conversion

1 to be in the public interest, any foundations resulting from
2 this conversion must receive the full value of Premera's
3 assets and they must also be free to maximize those assets
4 to address the healthcare needs of the citizens of
5 Washington - Washington and Alaska.

6 Premera's proposal fails to offer these minimum
7 requirements. In fact, Premera has gone to particular pains
8 to ensure that these minimum requirements are not offered.
9 It has repeatedly stated, at least during the hearing here,
10 that it only intends to transfer 100 percent of its stock
11 and it intends to keep the voting trust restrictions in
12 place even if it loses the Blues mark.

13 Unless and until Premera's request for conversion
14 provides basic peace of mind on these critical issues, it
15 should be denied.

16 Thank you.

17 JUDGE FINKLE: Thank you.

18
CLOSING ARGUMENT

19 BY MS. HAMBURGER

20
21 MS. HAMBURGER: Commissioner, I will be brief since
22 most of my comments have already been addressed by my
23 colleagues here, but first I want to thank you for ensuring
24 that this procedure has been - has really been an
25 extraordinary example of an open and public process. And on

1 behalf of the Premera Watch Coalition and the consumer
2 groups and consumers that we represent, we want to thank you
3 for having the opportunity to have input both here at the
4 administrative hearing and in the public hearings held
5 across the state. We think that alone has been just a
6 tremendous - tremendously important to making sure that this
7 process is fully before the public.

8 As Mr. Barlow said today, Premera has studied past
9 conversions and learned lessons from those past deals. And
10 what lessons could a company learn from past conversions?
11 Well, a company could learn that it is important to hide the
12 ball from the consultants and that way if the consultants
13 end up not supporting the conversion, the company could take
14 aim at the assumptions that the consultants are forced to
15 make.

16 The company could also learn to deny that it has the
17 obligation to transfer for a full market value to a
18 foundation. And then it could argue it is a gift.

19 A company could learn it is important to attach strings
20 to the proposed foundations so the company can continue to
21 control the foundation's activities well into the future.
22 And a company could learn it is much easier to do a
23 stand-alone conversion first and then later engage in a
24 merger with an out-of-state for-profit.

25 We believe that Premera learned those lessons and

1 learned them well and has employed those strategies here.
2 But at the same time, we have learned lessons. Consumers
3 have learned lessons from past conversions. And what we
4 have learned is that there have been many indications that
5 conversion hurts consumers, hurts healthcare providers. It
6 hurts the public interest. The nonprofit nature of the
7 state's health system once it is lost, it has gone forever.

8 Now, Premera mentions Mr. Benbow's response to the
9 Insurance Commissioner's question about whether it would be
10 possible to unring the bell in California, to undo the
11 WellPoint conversion. Mr. Benbow responded that bell has
12 been ringing a while, which means you can't go back again.

13 So we heard from Mr. Dauner things got a lot worse, in
14 his view, postconversion. And we heard from Mr. Reid that
15 no health impact study was ever done in California before
16 the conversion occurred.

17 Here, we have the benefit of the experts from the OIC
18 and from the Intervenors to understand exactly what could
19 happen here. The other lessons we have learned is that
20 postconversion, the compensation of top executives and board
21 members typically skyrocket. The lure of generous
22 postconversion compensation was part of the basis for
23 rejection of conversion in Maryland.

24 And another thing that we have learned is that the Blue
25 Cross/Blue Shield Association can be used to shield the

1 converting company from the regulator. And some of the
2 testimony we heard from Mr. Larsen reflected that.

3 Finally, we have also learned that eventual takeover by
4 WellPoint Anthem is likely, if not inevitable
5 postconversion.

6 Commissioner, we hope we have learned the lessons of the
7 past conversions and that they won't be repeated here in
8 Washington State.

9 As Mr. Milo mentioned, you need to look at the big
10 picture. Well, that big picture is what kind of harm will
11 result to our nonprofit health system here in Washington if
12 a conversion is approved? No assurances or conditions can
13 protect our communities from the changes in the health
14 system that will result from conversion. No foundation can
15 address the harm that we might experience.

16 Please protect our fragile health system and the needs
17 of all Washington consumers. Please reject the proposed
18 conversion.

19 JUDGE FINKLE: Thank you.

20 COMMISSIONER KREIDLER: Well, this brings us to the
21 conclusion. And I want to express my appreciation for the
22 counsels' presentations, the quorum, the degree of
23 professionalism that I have witnessed as the presiding
24 officer in this hearing. But it is very important for me to
25 express my deep appreciation to the Honorable George Finkle,

1 who acted as my special master, and his years of experience
2 and professionalism that he brought to this undertaking. I
3 can't overstate how much I appreciate that. Thank you so
4 very much, Your Honor.

5 JUDGE FINKLE: Thank you.

6 COMMISSIONER KREIDLER: And also to the staff that
7 helped to put together this hearing, from my staff, from the
8 Office of Insurance Commissioner from the standpoint of the
9 logistics of all that went into pulling all this together.
10 We very much appreciate what they were able to pull together
11 as the location was somewhat moved from one point to
12 another. And we were always able to find a place where we
13 can conduct our meetings in the appropriate fashion.

14 This is one condition that I set forward early was - and
15 it has been stated by several here today and before - is to
16 conduct a very open process from start to finish. There is
17 still an opportunity for the public to offer comments that
18 can be entered into a part of the record from the public
19 comments. They can do that by mail to me or by the Internet
20 through our website and they are encouraged to do so. I
21 certainly have a lot of information now to consider in the
22 coming weeks before I render my final decision on the - no
23 later than the 19th of July.

24 But it is to all of you that I appreciate the effort and
25 work that you put into this undertaking for - for the OIC

1 staff and Premera, for the Intervenors and to my inside
2 assistants, to my right over here, who offered me advice and
3 counsel throughout this process.

4 This does conclude the formal hearing on the matter of
5 the Form A filing by Premera to convert from not-for-profit
6 to a for-profit company. With that, I conclude this
7 meeting. Meeting adjourned.

8 MR. COOPERSMITH: Thank you, Commissioner.

9
10 (Proceedings concluded.)
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C E R T I F I C A T E

I, KRISTIN D. MANLEY, a court reporter in the State of Washington, do hereby certify that I was present during the foregoing matter and reported said proceedings stenographically.

I, DO FURTHER CERTIFY that the foregoing transcript constitutes a full, true, and accurate transcript of that portion of my stenograph notes so taken and so ordered.

I, DO FURTHER CERTIFY that I am not related to any of the parties to this lawsuit, nor am I interested in the outcome thereof.

Dated this 20th day of May, 2004.

KRISTIN D. MANLEY

CCR NO. 2211